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Temple-Inland









1998 Annual Report

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Temple-Inland Inc. is a holding company with operations in paper, building products and financial services.



The Paper Group's corrugated packaging operation produces containerboard and a complete line of corrugated containers, including shipping boxes, retail packaging and point-of-purchase displays. The group's bleached paperboard operation produces various grades and weights of coated and uncoated paperboard for use in high-quality printing and publishing applications, greeting cards, office supplies and foodware.



The Building Products Group manufactures a wide range of building products, including lumber, plywood, particleboard, medium density fiberboard, gypsum wallboard, fiber-cement siding and fiberboard products.



The Financial Services Group consists of savings bank activities, mortgage banking, real estate development and insurance brokerage.

Forest resources include approximately 2.2 million acres of timberland located in Texas, Louisiana, Georgia and Alabama.



Based in Diboll, Texas, Temple-Inland is a Delaware corporation that was organized in 1983. Its principal subsidiaries include Inland Paperboard and Packaging, Inc.; Temple-Inland Forest Products Corporation; Temple-Inland Financial Services Inc.; Guaranty Federal Bank, F.S.B.; and Temple-Inland Mortgage Corporation.

Temple-Inland's common stock is listed on the New York Stock Exchange and the Pacific Exchange under the ticker symbol TIN.

This annual report contains forward-looking statements that involve risks and uncertainties. The actual results achieved by Temple-Inland may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such differences include general economic, market or business conditions; the opportunities (or lack thereof) that may be presented to and pursued by Temple-Inland and its subsidiaries; the availability and price of raw materials used by Temple-Inland and its subsidiaries; competitive actions by other companies; changes in laws or regulations; and other circumstances, many of which are beyond the control of Temple-Inland and its subsidiaries.

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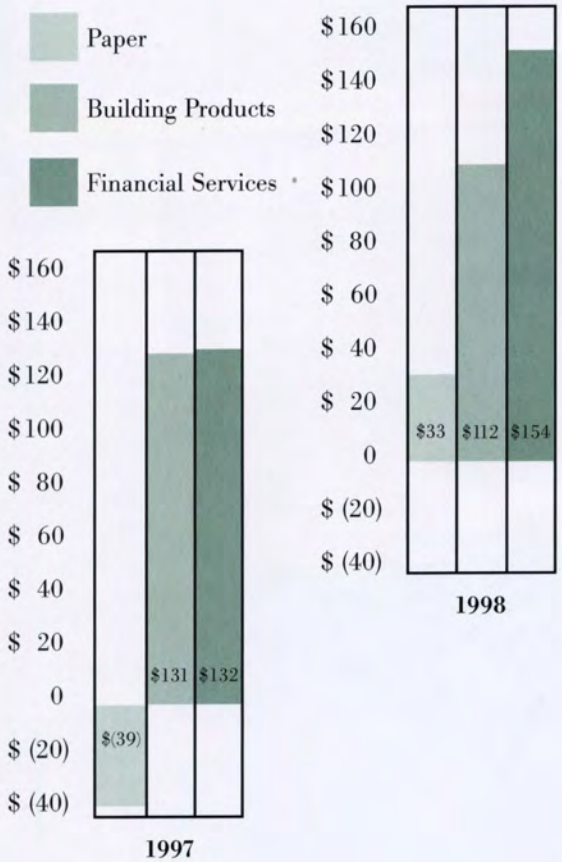
SEGMENT OPERATING INCOME

(in millions)



FINANCIAL HIGHLIGHTS

	1998	1997	Percent Change
(in millions, except per share data)			
Total Revenues	**$3,740**	$ 3,625	3 %
Manufacturing Net Sales	**$2,631**	$ 2,680	(2)%
Net Income	**$ 64**[a]	$ 51	25 %
Earnings Per Share:			
Basic	**$ 1.16**	$ 0.91	27 %
Diluted	**$ 1.15**	$ 0.90	28 %
Dividends Per Share	**$ 1.28**	$ 1.28	—
Shareholders' Equity	**$1,998**	$ 2,045	(2)%
Book Value Per Share	**$35.93**	$ 36.31	(1)%
Weighted Average Shares Outstanding:			
Basic	**55.8**	56.0	—
Diluted	**55.9**	56.2	(1)%
Common Shares Outstanding at Year End	**55.6**	56.3	(1)%

[a] *Includes a special after-tax charge of $28.9 million, or $0.52 per share, and a $3.2 million charge, or $0.06 per share, from cumulative effect of accounting change.*

SELECTED BUSINESS SEGMENT DATA

	1998	1997	Percent Change
(in millions)			
MANUFACTURING NET SALES			
Paper	**$2,018**	$ 2,063	(2)%
Building Products	**$ 613**	$ 617	(1)%
OPERATING INCOME			
Paper	**$ 33**	$ (39)	185 %
Building Products	**$ 112**	$ 131	(15)%
Financial Services	**$ 154**	$ 132	17 %

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Clifford J. Grum (right), Temple-Inland chairman and chief executive officer, and Kenneth M. Jastrow, II, president and chief operating officer, are pictured inside part of a new interactive exhibit at the Austin Children's Museum called "Lives of the Tree," which received significant financing from the Temple-Inland Foundation. After its debut in Austin, Texas, the exhibit will travel nationally.

To Our Shareholders

Achieving improved returns was both a priority and a challenge during 1998, as our businesses experienced varied results.

The recovery of our paper markets, which was occurring as the year began, abated during the last three quarters. Difficult market conditions developed as worldwide demand decreased to below normal levels. The Building Products Group had another good year, and the Financial Services Group achieved its fourth consecutive record year of operating earnings.

Earnings per share were $1.73, compared with $0.90 last year, before non-recurring items after-tax of $32.1 million ($0.58 per share). The non-recurring items consisted of a special after-tax charge of $28.9 million and the cumulative effect after tax of $3.2 million for changing the method of accounting for start-up costs and training activities. Even though earnings before the special charge were up 92 percent from last year's depressed level, they provided far from an adequate return on our shareholders' investment.

Instability in worldwide paper markets accelerated our efforts to restructure the paper operations and reduce their dependence on commodity markets. These efforts included closing our Newark, California, corrugating medium mill and the adjacent corrugated packaging plant; reorganizing our corrugated packaging distribution network to a more decentralized, market-responsive operating group; and restructuring overhead operations to support both our paper mills and corrugated packaging distribution groups.

The goal of these efforts is to increase the Paper Group's earnings by $150 million without the benefit of the expected recovery in paper markets. Our goal is to achieve approximately one-third of this increase in 1999 and complete the program in the next three years. A portion of the special charge was related to this restructuring program.

While our Mexican box plant operations continue to improve and have now achieved profitability, our two South American units continue to be unprofitable. Although both South American facilities have been subject to very difficult operating environments, we are committed to achieving profitable operations in the near future. Otherwise, we will consider other alternatives, including liquidating these investments. A reserve for asset write-downs in connection with the South American operations was included in the special charge.

In the last three years, the Building Products Group has been renovating its sawmills to be more efficient in converting smaller logs to lumber. We have completed modifications to the Rome, Georgia, and Buna, Texas, mills and, in the next 18 months, we will complete the rebuild of our Diboll and Pineland, Texas, sawmills. The Diboll modification will be a major upgrade, including virtual replacement of our oldest sawmill. We will convert the Pineland plywood complex to lumber production. Included in the special charge was a reserve for asset impairments at the Diboll and Pineland mills. In addition to the special charge, we also wrote off the remaining balance of previously capitalized start-up costs and training activities.

Reflecting the growth of the U.S. economy, domestic corrugated box volumes began 1998 relatively strong. Export markets, however, had begun to deteriorate. As the year progressed, both markets declined and we were forced to moderate paperboard production to balance inventory levels. This downtime reduced production by an estimated 236,000 tons, approximately 9 percent of our annual capacity and a 200,000-ton increase from 1997.

As we enter 1999, our inventory levels are satisfactory, and new worldwide containerboard capacity increases are at the lowest level in many years. In fact, if several industry mills currently in the process of being "mothballed" remain idle in 1999, actual worldwide capacity may decline.

Our efforts to improve profitability last year included developing a more select customer base and exiting less profitable accounts. Although our corrugated packaging sales volume growth was lower than anticipated, margin improvement offset these lower volumes and increased profitability. In 1999, our goal is to regain sales growth without diminution of margins.

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Our bleached paperboard operation experienced market pressures as worldwide demand remained below capacity and price discounting became more prevalent. We were able to achieve a more favorable sales mix, especially in the second half of the year, improve productivity and lower manufacturing costs. The focus for 1999 will be to further improve mix in targeted grades.

For the Building Products Group, 1998 was a historic year in building for the future. Despite the most difficult lumber markets of the decade and the start-up of two new joint-venture facilities — a medium density fiberboard (MDF) facility in Arkansas and a fiber-cement plant in Texas — the group achieved the third most profitable year in its history.

Lumber markets were faced with an increased supply of wood from both U.S. and Canadian competitors that normally export their production to Asia. This increase in supply, despite good residential housing construction levels, reduced pricing while the cost of wood fiber remained high, especially in the first half of the year. Fortunately, we were able to remain profitable in our solid wood operations, primarily as a result of our sawmill conversion program and our diversified product mix. With the price of outside fiber beginning to decline, profitability should improve in 1999. When we complete the modification of the Diboll and Pineland complexes, our lumber operations should be one of the most productive systems in the United States.

Our manufacturing operations continue to enjoy the benefits of low-cost fiber grown on our 2.2 million acres of timberland. Last year, these lands provided 61 percent of the fiber used by our solid wood operations; and the by-products of this conversion, plus fee pulpwood, were 64 percent of the pine requirements of our paper mills. Our forests will continue to be more productive in the future, allowing either a higher percentage of self-sufficiency or additional facility expansion.

Our particleboard operations, with the addition of the Hope, Arkansas, plant and renovation of all existing plants, gave us the ability to improve product mix. Because many of our particleboard customers also use substantial volumes of MDF, especially in manufacturing cabinets and furniture, we constructed a joint-venture plant in Arkansas to increase our product line. In the third quarter, we acquired two additional MDF operations, one in Pembroke, Ontario, Canada, and one in Clarion, Pennsylvania. These acquisitions will allow us to cover a wide range of geographic markets, including expansion into Canada.

Many of our customers require a thinner MDF panel than traditional facilities can produce. A continuous press is required to produce these panels effectively. Each of our three MDF facilities has a continuous press, which will be important to our future growth in MDF products.

All three MDF plants are new facilities in start-up mode of operation. These facilities probably will not contribute to earnings in 1999, but will provide an important income stream for future years.

Our fiber-cement joint venture experienced construction delays but was able to begin production activities in the fourth quarter on one machine. The second machine is scheduled to begin operating in the first quarter of 1999. Initial production is encouraging and we are now producing our top-grade siding product, which has had good initial reception in the marketplace.

Construction of our new joint-venture gypsum wallboard mill in Cumberland City, Tennessee, is ahead of schedule, and we now anticipate initial production at this facility in the third quarter of 1999.

Our bank, Guaranty Federal Bank, and its mortgage banking subsidiary, Temple-Inland Mortgage Company, enjoyed another year of record growth and profitability. The bank completed the integration of its initial acquisition in California by mid-year and, in November, we announced further expansion through the acquisition of Hemet Federal Savings & Loan Association. The $118 million transaction, subject to shareholder and regulatory approval, is expected to close during the second quarter of 1999. Hemet, with deposits of almost $1 billion and 18 branches, will expand our deposit-gathering capabilities to Southern California.

Lower interest rates in 1998 allowed the mortgage bank to enjoy record levels of new production from the combination of good housing markets and favorable refinancing opportunities. Unfortunately, this refinancing market created large prepayments of existing loans. Many of these loans were more tenured mortgages with higher rates and lower balances than the loans we were

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currently producing. Therefore, we ended the year with an improved servicing portfolio with larger average monthly payments and lower interest rates. This should add to servicing profitability in the future. Further, the lower interest rate protects us from refinancing unless rates continue to decline.

The bank's loan portfolio continued to grow without deterioration in credit quality. Its diversified loan activities have allowed it to expand in growth segments of the market and not be solely dependent on any single source of loans.

Last year, the company made several management changes. The most significant was the elevation of Kenneth M. Jastrow, II, to the position of president and chief operating officer of our corporation. Previously, Kenny had served as group vice president of the Financial Services Group and chief executive officer of Guaranty Federal Bank. Clifford J. Grum remains chairman and chief executive officer of the company. Kenny and Clifford will be working as a team until Clifford's retirement in December.

Kenneth R. Dubuque joined our organization in October as president and chief executive officer of Guaranty Federal Bank. We welcome Ken to our organization.

Our Paper Group restructured its management team. Joseph E. Turk, vice president-corrugated packaging, has taken leadership of the bleached paperboard operation, combining both the mill and selling functions under single management. Bart J. Doney is now in charge of our corrugated packaging operation.

Ted A. Owens, group vice president-containerboard, elected to take early retirement after 23 years of service. We thank him for his leadership over our paper mills and wish him the best for a long, prosperous retirement. Replacing Ted is James C. Foxworthy.

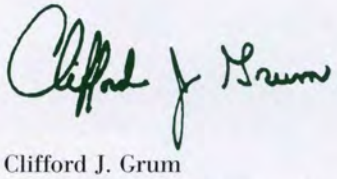
Paul M. Anderson is now president and chief executive officer of Broken Hill Proprietary Company, Ltd., in Australia. As a result of his move, Paul resigned as an active director, but agreed to remain in an advisory capacity. We wish Paul well in his new executive position and look forward to his continued relationship with us.

The company continued its stock repurchase program with 850,500 additional shares acquired during the year. At the May meeting, the board reviewed this program and authorized acquiring up to 2.5 million additional shares.

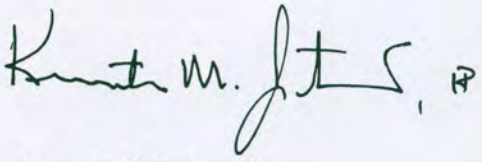
In summary, last year's recovery was only the beginning of a return to a satisfactory earnings level. We appreciate the efforts of all of our more than 15,000 employees to improve profitability. Nevertheless, the process improvements are only partially completed and must be brought to fruition.

As we begin 1999, market conditions may continue to be difficult, but all of our operations are committed to being more productive and, therefore, less dependent on markets than in the past for improved profitability.

Sincerely,



Clifford J. Grum
Chairman and Chief Executive Officer



Kenneth M. Jastrow, II
President and Chief Operating Officer

January 30, 1999

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Inland's high-quality graphics on traditional corrugated packaging help attract consumers and influence buying decisions.

Paper

Temple-Inland's Paper Group weathered another difficult year characterized by continued industry overcapacity, which created extreme price discounting. The Asian financial crisis directly affected the industry and weakened demand for the company's products in overseas markets. Additionally, the group's Latin American operations were negatively affected by currency devaluations in most of its operating environments.

In diligent pursuit of a vision

In response to the losses and shifting markets of 1997, the group's corrugated packaging operation began 1998 by launching an aggressive margin-enhancement initiative. The goal of this initiative is to create a more competitive company that is better equipped to serve customer needs through improved products and services, and thereby enhance shareholder returns.

This intensive effort is known as **M***plus* **50** to signify the initial target of generating $50 million additional earnings beyond market conditions. Numerous employee teams were mobilized to help make the company's new vision a reality.

The teams focused on three key cost areas—reducing waste, leveraging procurement power and improving maintenance—and targeted margin improvement to better serve a more select customer base. These efforts and a variety of other cost-improvement projects will decrease Inland's total cost of goods sold, boost revenues and increase organizational efficiency and effectiveness by changing how the group does business.



As part of **M***plus* **50**, the company took a major step toward becoming a more decentralized, lower-cost organization by restructuring its U.S. packaging operations into eight districts, each comprised of three to six plants. On the containerboard side, six mills began operating as distinct business units to focus on each mill's earning power and return on investment. To lower overhead costs, the mills are supported by a core management group for sales and marketing, operations planning and development, finance, and human resources.

In order to become more entrepreneurial and market driven, each of these business units now has full profit responsibility for its assets, staffing, market planning and sales execution. The managers of the new districts and mills have completed their respective reorganization plans.

The challenge is to achieve an average 18.5 percent pre-tax return on investment. Approximately $20 million in annualized savings is currently being realized as a direct result of the **M***plus* **50** teams' work at the individual plants and mills to implement best-practice procedures collected from across the organization. Another $30 million in savings from **M***plus* **50** is targeted to be achieved in 1999. Work will then continue to capture an additional $100 million in profit improvements during the next three years.

Volume and prices drop with demand

Improvements in the Paper Group's earnings for 1998 were due primarily to higher average prices for corrugated packaging and paperboard. Box prices averaged 11 percent higher in the first half of 1998, compared with 1997, but deteriorated during the second half as demand weakened. For the year, average box prices were 7 percent higher than 1997.

Industry packaging shipments were relatively flat for the year, up less than 2 percent from 1997 levels, as demand weakened during the course of 1998. Demand for containerboard in certain export markets, especially Asia, also declined during the year. As a result, the company took 236,000 tons of voluntary downtime at its containerboard mills (compared with 36,000 tons of voluntary downtime taken in 1997).

The cost of old corrugated containers, used as a source for approximately 46 percent of the mills' total fiber needs, dropped during the year, while the cost of virgin fiber remained high. As a result, the mills in Rome, Georgia, and Orange, Texas, which use virgin fiber predominately, took more voluntary downtime than the other mills to accommodate this cost shift.



William B. Howes
Chairman and Chief Executive Officer, Inland Paperboard and Packaging, Inc.

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Inland adds value for its customers through colorful, innovative consumer packaging solutions.

Taking the necessary steps

To help offset these market forces, the group accelerated efforts to continue developing relationships with new customers that seek value-added products, thereby providing the company with higher margin opportunities. Additionally, the company chose to part with certain customers whose requirements did not allow sufficient profitability.

In February 1998, the Paper Group announced the closure of a corrugated packaging plant and mill operation in Newark, California. The 45-year-old facility had become noncompetitive and was no longer able to meet income requirements.

In October, the group sold its Rexford Paper Company division. Most of Rexford's operations did not fit into the group's core business strategy. The TruTech™ product line was retained based on the promising sales prospects of this innovative paper-plastic laminate product, a decision that is in line with the company's drive to provide customers with value-added solutions to their packaging requirements.

In another step to enhance total customer service, the group opened two new sheet plants in Tennessee and Virginia. Smaller than the packaging plants, these converting and printing facilities specialize in handling lower-volume requests, including special container runs and complex displays.

Latin American operations work through many challenges

With the exception of Argentina, each of the Latin American operations showed improved operating results, although currency devaluations, which were particularly severe in Mexico, diluted the financial gains.

The new corrugated packaging plant in Sinaloa, Mexico, continued to improve its productivity. Start-up costs were high, however, and negatively affected results for the year.

Task teams were formed with employees from other Inland facilities to help stem the continued losses at the company's operation in Argentina. Progress to date has been encouraging, and efforts are now being focused on creating a new operating culture that will allow this plant to better serve growing market demand for corrugated packaging.

In Guanajuato, Mexico, the group opened a "speed-to-market" center for new products in Latin America. The group also made significant progress in introducing new machine-packaging systems to the growing agricultural markets in both Mexico and South America. Additionally, these plants realized strong advances during the year in strategic planning, organizational development, intercountry teamwork and best-practice management.

Scoring retail sales



The Paper Group's consumer packaging and display operations continued to gain market share in the highly competitive retail sector where customers demand the highest quality and most innovative packaging designs.

Studies have shown that approximately 70 percent of buying decisions occur when the consumer is in the store looking at the multitude of products on the shelves. In response, the group's ScoreZone™ approach to retail sales has been designed to reach consumers at all the points where they are likely to consider a product. Free-standing point-of-purchase displays, interactive kiosks, on-shelf coupons, end-aisle product displays and other tools are strategically employed to attract potential customers through the use of bold graphics, true-to-life colors and creative configurations.

Sales for the consumer packaging and display operations increased 12 percent in 1998, compared with 1997, as the unit continued to build business in the three primary sectors of litho-laminate, enhanced post-print and displays. Another measure of this business unit's growing success is in the numerous supplier-of-the-year awards it received, as well as trade association recognition for cutting-edge developments in creativity and printing technology.



(Left) Bart J. Doney
Executive Vice President, Packaging Group
(Right) James C. Foxworthy
Executive Vice President, Paperboard Group
Inland Paperboard and Packaging, Inc.

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In addition to its use in packaging, bleached paperboard is converted into greeting cards, office supplies, disposable foodware and many other products.

Similar to the **M***plus* **50** program underway within the traditional corrugated packaging and mill businesses, consumer packaging launched its own profit-enhancement initiative to redesign the organization and position itself for future growth. Concentrating primarily on the critical issue of speed-to-market, the group is working to reduce total cycle time by eliminating non-value-added work and inventories, as well as eliminating waste.

Collectively, the three plants in Leominster, Massachusetts; Harrington, Delaware; and Ontario, California, are seeking to reduce by 64 percent the time it takes to complete an order and greatly accelerate the speed of their customers' new product introductions. Additionally, the plants are looking to reduce process waste by 50 percent and inventory levels by 40 percent. Currently, the plants are on target for achieving these results by year end 1999.

Bleached paperboard sees operations improvements

Prices for bleached paperboard, manufactured at the Inland Eastex mill in Evadale, Texas, continued to suffer downward pressures in 1998. Product mix improvement and lower operating costs, however, combined to offset some of the effect of the declining prices.

Besides continued progress in controlling costs, much of which was realized by raising pulp and machine yield rates, the unit also worked to align its product mix to those markets that require demanding and high-quality performance characteristics. Good momentum was achieved in a number of these industry sectors, including commercial printing; office products; and packaging for pharmaceuticals, cosmetics and other consumer goods.

TexCoverII™, a premium-grade cover stock, continued to be a leading industry performer in 1998. But market research showed that it was suffering from an "identity crisis" caused in part by its name. The term "Tex" was originally incorporated into the product name to identify the State of Texas, following the industry practice of identifying paper products with their manufacturing location. The research, however, showed that the name led potential customers to believe that it could be either a text-weight paper or a cover-weight stock.

In August, a new identity and advertising campaign was launched for this product, based on the name Tango™. An innovative marketing approach was designed to eliminate the confusion, as well as to reinforce with commercial printers that Tango outperforms every other cover-weight stock in terms of even coating, defect-free surface qualities and minimal cracking.



The Paper Group's new organizational structure will allow each mill and corrugated packaging plant to better serve its respective customers, and thus increase earnings. The renewed commitment to customer service will be paramount in aligning the proper quality and volumes with the specific needs of the marketplace.

Armed with a new vision, the group took several key steps in 1998 that have placed it squarely on the path to becoming successful in the global marketplace, thereby increasing its ability to achieve targeted returns on invested capital.



Joseph E. Turk
Executive Vice President, Inland Eastex

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Temple-Inland's medium density fiberboard is used in a wide variety of applications, including cabinets, moldings and laminate flooring.

Building Products



Temple-Inland's Building Products Group capitalized on 1998's strong economy and the significant rise in housing starts. Virtually all of the group's business units benefited from the brisk level of residential and commercial construction. Pricing improved for all product lines except lumber.

A North American industrial panel leader

Already a market leader in the particleboard industry, the company significantly enhanced its competitive position in the broader composite panel market with the acquisition of two medium density fiberboard (MDF) production facilities from MacMillan Bloedel Limited for approximately $106 million. The plants are located in Clarion, Pennsylvania, and Pembroke, Ontario, Canada, and each is capable of producing 130 million square feet of MDF annually.

Combined with the company's new joint-venture MDF plant in El Dorado, Arkansas, which came on line during the second quarter of 1998, these facilities give the Building Products Group total capacity of more than 410 million square feet of MDF annually. The acquisition also fits well into the company's strategic growth plan, because many particleboard customers also use MDF.

MDF is rapidly finding high market acceptance from furniture and cabinet manufacturers, as well as in architectural applications, such as interior trim and moldings. Thinner panels of MDF are especially valued by producers of laminate floor systems, retail display fixtures and door components. The company's three new plants will be capable of supplying a major share of this growing thin-panel MDF market, due primarily to their advanced continuous-press capabilities and reputation for consistent quality.

Sales of traditional particleboard were up slightly in 1998 as the company continued to benefit from increased production at its plant in Hope, Arkansas, and profits increased as sales mix improved.

Shoring up lumber

Average lumber prices dropped 10 percent in 1998, compared with 1997, as a lack of demand in certain export markets, particularly Asia, resulted in more domestic supply from mills that traditionally serve these foreign markets. The situation deteriorated during the year as non-domestic suppliers increased imports to capitalize on the relatively strong U.S. dollar.

Temple-Inland's 2.2 million acres of timberland provide approximately 61 percent of the Building Products Group's solid wood fiber requirements. This self-sufficiency helped to offset the downward pressures on profitability of the lumber operations, and the group continued its mission of enhancing its productivity, including modernizations for better alignment of fiber resources and other operating-cost reductions. These efforts are designed to help ensure that the group's solid wood converting facilities will be the most efficient in the United States.

In 1998, the group completed a modernization of its sawmill in Buna, Texas, and is currently in the process of upgrading its mill in Diboll, Texas. In Pineland, Texas, a new sawmill will be constructed in 1999.

Gypsum wallboard continues to perform well

Gypsum wallboard sales for the year improved over 1997, led by the company's popular Stretch 54® product. Stretch 54 is valued by both contractors and do-it-yourselfers because its larger size saves time and material costs in houses with 9-foot-high ceilings. It also provides flatter, smoother



Harold C. Maxwell
Chairman and Chief Executive Officer, Temple-Inland Forest Products Corporation

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Builders choose Stretch 54® gypsum wallboard for ease of application, less waste and superior performance.

walls with fewer seams. Average gypsum prices increased throughout the year and were 8 percent higher than in 1997.

Construction of the company's new joint-venture gypsum wallboard plant in Cumberland City, Tennessee, continued on schedule during the year. The plant is slated for completion in the summer of 1999 and will use as its raw material the by-product of a nearby coal-burning power facility.

The anticipated cost efficiency of this synthetic gypsum operation, as well as its geographic location, will help the Building Products Group more easily serve the fast-growing construction markets in the Southeast and allow it to supply its expanding customer base in nearby markets.

Many sides to the siding business

The group's hardboard siding products continued to battle alternative siding for market share. Sales of TrimCraft™ remained strong due to the high satisfaction of contractors and remodelers who use this engineered wood product for exterior trim. TrimCraft is free of defects and comes in 16-foot lengths, which makes it easier to install, requires fewer seams and reduces waste. It is also easy to paint, which helps reduce overall labor costs in new construction.

In a major move to diversify its product offerings, the group completed construction of a joint-venture fiber-cement plant in Waxahachie, Texas, in the fourth quarter of 1998.



The company chose to enter this market niche based on high builder demand for the superior durability and weather resistance this siding material offers.

When fully operational, the new facility is expected to produce 120 million square feet of fiber-cement siding and related products per year.

The company's Building Products Group continued to construct a solid and diversified foundation of quality product lines during 1998. As the economy continues to grow, so should the group's prospects for continued revenue gains.

However, broad economic conditions can shift quickly. Therefore, the group remains focused on further asset growth to bolster future earnings and on a commitment to superior customer service and quality.



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Guaranty Federal Bank is dedicated to personal service and fulfilling customers' total financial needs.

Financial Services

1998 proved to be another milestone year for Temple-Inland's Financial Services Group as it achieved record operating earnings, deposits and loans outstanding. All four lines of business—banking, mortgage lending, real estate development and insurance services—reported profitable results.

Acquisitions extend mission and strategy



Guaranty Federal Bank, F.S.B. completed the integration of its 1997 acquisition of Stockton Savings Bank, located in the Central Valley area of California. Guaranty has a focused strategy to increase earning power by building its targeted customer base in new markets through acquisitions and growing its deposit base within existing branches. Guaranty's strategy is to distinguish itself from the competition by providing progressive products and quality service to its customers, all with the highest levels of personalized attention.

In line with this successful strategy, Temple-Inland signed a definitive merger agreement in late 1998 with HF Bancorp, Inc., the parent company of Hemet Federal Savings & Loan Association. Hemet has approximately $1 billion in assets with 18 branches in the dynamic Southern California markets of Riverside County, Palm Springs and Northern San Diego County. The $118 million transaction, which is subject to shareholder and regulatory approval, is expected to close in the second quarter of 1999, allowing Guaranty to expand its operations into Southern California and further participate in the recovery of the California economy.

In addition to expanding its customer base, Guaranty continued to focus on two basic operating principles: growing a quality loan portfolio and consistently striving to be one of the industry's lowest-cost savings banks.

Serving customers' total financial needs

Guaranty provides its customers with competitive products and services at 135 branches. Its Texas operations are concentrated in the metropolitan and adjacent areas of Dallas/Ft. Worth, Houston, Austin and San Antonio, as well as East Texas. In California, the bank's deposit activities are concentrated in the Central Valley area and will be expanded to more southern markets once the Hemet transaction is completed. These California branches are located in markets that match Guaranty's target-customer profile, allowing the bank to offer personalized service and its full range of products.

During the year, Guaranty also concentrated on the development and growth of new loan markets. The institution's lending groups achieved record earnings for the eighth consecutive year, despite increased competition, low interest rates and a flat yield curve.

The bank's largest asset category involves loans related to single-family residences. This includes adjustable-rate mortgage loans, mortgage-backed securities, construction loans for single-family houses, warehouse lending to mortgage banks that originate and sell single-family loans, and second-lien loans for home improvements and purchase money mortgages. Approximately 75 percent of the bank's total assets are invested in providing credit for the nation's housing needs.

The real estate lending group extended its national reach and now has a presence in 50 major metropolitan areas throughout 28 states. The group continued its strategy of product diversification by expanding its construction lending services to national home builders, senior-housing developers and office construction companies. These diversified lending areas complement the group's commitment to the multi-family housing, retail and industrial markets.



Kenneth R. Dubuque
President and Chief Executive Officer, Guaranty Federal Bank, F.S.B.

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The company's mortgage lending operations help make the dream of home ownership a reality for families across the country.

The benefit of being a significant national mortgage warehouse lender was clearly demonstrated during the year as high refinancing levels and low interest rates fueled Guaranty's strong performance. This strategy served to offset the negative impact from a decline in the bank's adjustable-rate mortgage portfolio.

Guaranty's rapidly growing consumer lending division also achieved outstanding results in 1998. The division's earnings quadrupled, compared with 1997, and its product offerings, including automobile lending, second-lien real estate lending and education lending, were expanded throughout Texas and into several surrounding states. Further expansion of consumer lending products to the bank's key California markets will be initiated in 1999.

Guaranty's corporate banking group, which provides financing products to middle-market companies, was one of the fastest-growing business lenders in Texas, doubling in size during the year. With the acquisition of Stockton and the completion of the Hemet transaction, corporate banking will expand its operations to California and other markets.

Helping customers realize the American dream

Temple-Inland Mortgage Corporation (TIMC) is one of the nation's largest lenders to single-family home buyers. TIMC is a full-service mortgage banking company, originating loans through 78 retail and wholesale outlets.

In 1998, this business unit realized record levels of new mortgage originations, with total production of $6 billion, almost double 1997 levels. Lower interest rates were the primary contributing factor, resulting in high refinance activity and accelerated purchases of new and used housing.



This interest rate environment, however, also created higher levels of prepayments in the loan servicing portfolio. TIMC elected to strategically sell certain high-rate servicing to reduce exposure to increased levels of refinancing activities.

As a result, the servicing portfolio declined $3.2 billion to $22.9 billion for the year. Despite this decrease, the characteristics of the portfolio, including a larger loan size, lower average interest rate and longer length to maturity, will create higher levels of potential earning power.

Insurance and real estate complete the diverse picture

Temple-Inland's Financial Services Group also includes Timberline Insurance Managers, Inc., an insurance brokerage operation, and Lumbermen's Investment Corporation, a real estate development company.

Timberline is the third-largest insurance agency in Texas and is ranked in the top 1 percent nationally, based on premium revenue. In 1998, Timberline's premiums totaled $306 million, an increase of 5 percent over 1997. The group has acquired six agencies over the past five years and will actively continue to pursue acquisitions to increase earning potential.

Timberline offers a comprehensive range of financial products and services, including personal and commercial lines of protection, annuities, life and health insurance, and risk-advisory services.

Lumbermen's has real estate holdings in nine states, primarily Texas, Colorado, Florida and California. In 1998, it returned to profitability as a result of increased sales of single-family lots and commercial properties. While the group's primary focus is on single-family real estate development, it sold a commercial building in 1998 for a gain of $10 million.

The Financial Services Group maintained its track record of solid performance in 1998. Strategic acquisitions, customer focus through personalized service, product diversification and low-cost operations continue to be successful.

As Temple-Inland enters the 21st century, it expects its financial services arm to produce high earnings and serve as an excellent balance in the company's total mix of assets.

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Temple-Inland's state-of-the-art forestry practices will substantially increase growth on its 2.2 million acres of diverse timberland.

Forests

Temple-Inland's extensive timberlands represent a valuable resource for both the company and the ecological balance of the regions in which the forests are located.

With approximately 2.2 million acres of owned and leased timberland in Texas, Louisiana, Georgia and Alabama, the company has established a viable source of raw material for its solid wood and paper mill operations. This provides a critical hedge against future market fluctuations.

Pine resources from company lands represent approximately 63 percent of the pine fiber requirements necessary to operate the company's paper and solid wood converting operations. In addition, the company has approximately 175,000 acres of natural hardwood stands, 150,000 of which are located in Texas and Louisiana, with the remaining acres in Georgia and Alabama. Hardwood fiber is regarded as a premier pulp component and is used primarily at the company's bleached paperboard mill in Evadale, Texas.

Temple-Inland carefully manages its forest land as a sustainable resource and pursues its fiber production goals in the most environmentally responsible manner possible. Business decisions are made with consideration to the total forest environment, including wildlife, biodiversity and aesthetic issues.

Serving as steward

When Temple-Inland introduced its comprehensive forestry guidelines in 1996, it committed the entire organization to applying its land-management programs directly on the forest floor.

In 1998, these actions were formally recognized when the company received the Environmental Protection Agency's distinguished Environmental Excellence Award. The award honors the company's leadership in monitoring the effectiveness of Best Management Practices (BMPs) for forestry and, specifically, for efforts to protect the forest watershed. Regulated in some states, Temple-Inland's BMP program is voluntary and helps to ensure that the quality of stream water on all company land is carefully protected.



Organized around the perpetual forest

To better align management activities and improve efficiencies and long-term planning, the company's forestry unit is organized into three key areas — forest management, procurement and harvest allocation. Throughout the organization, intensive forest-management practices are applied in ways that allow nature to do its best work.

In Texas and Louisiana, for example, the majority of the company's acreage is used in the production of conventional sawlogs. Under this program, genetically superior trees are grown for approximately 15 years. Then, about one-third of the trees in the stand are removed and used as pulpwood for the production of paper. After thinning, the remaining trees in the stand flourish as they take in more sunlight and have available more water and soil nutrients. At approximately 22 years, the trees are thinned again, with most of the wood used for lumber. Within an additional 10 to 12 years, the remaining trees will provide fiber for premium-quality lumber.

Another technique for improving profitability of the forest is known as "sudden sawlogs." Designed to produce premium products, young trees are carefully pruned so that fewer limbs will develop in the lower sections. This eliminates knots when the trees are ultimately converted to lumber, providing a higher grade wood. This forest-management technique also improves the aesthetic qualities of the forest.



Jack C. Sweeny
Group Vice President, Temple-Inland Forest Products Corporation

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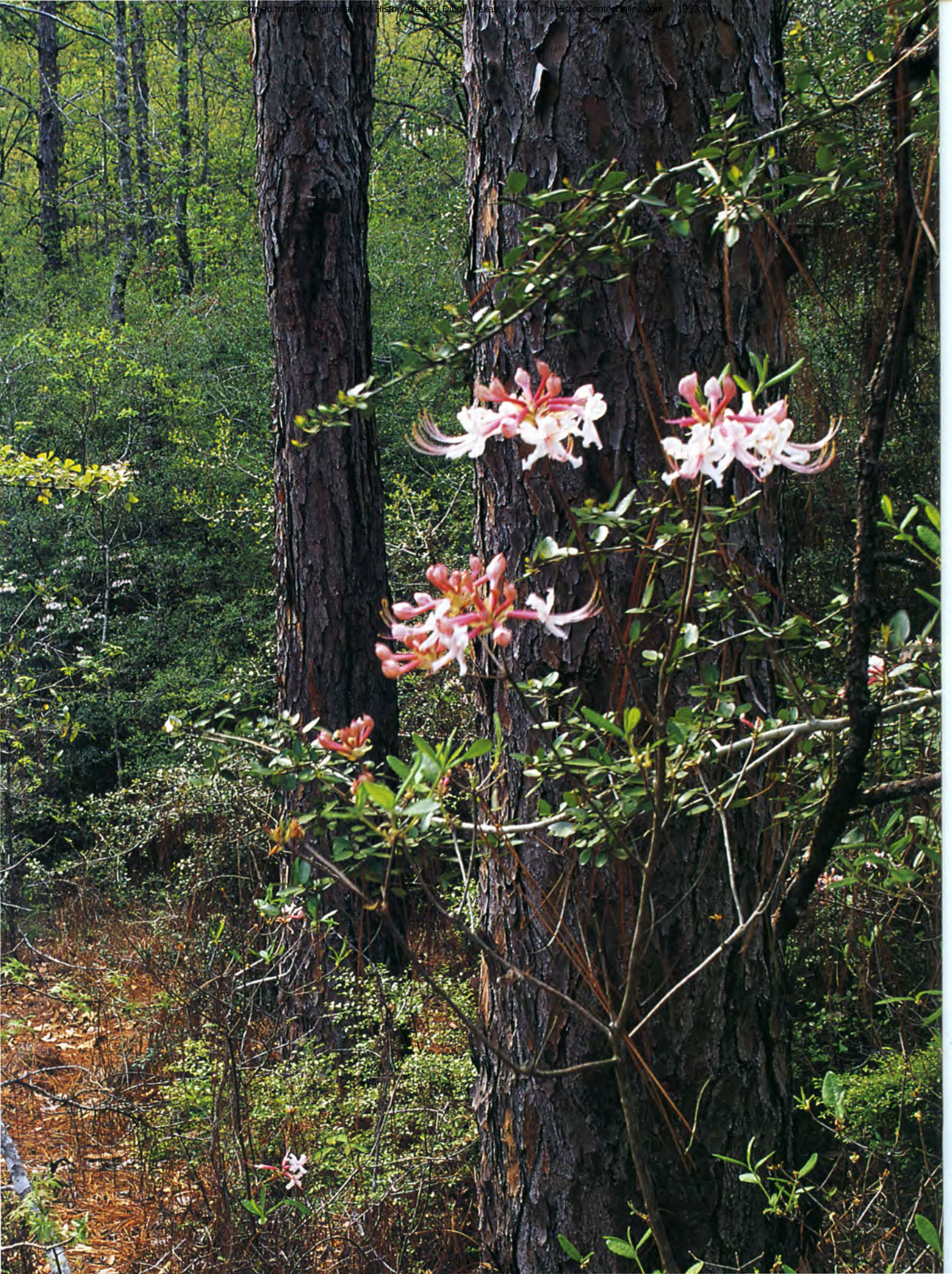

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The company utilizes the majority of its timberland in Georgia and Alabama to produce pulpwood. Using a short rotation cycle, most of these stands are managed with minimal thinning for approximately 20 years before being harvested.

Through the use of computer systems and other technologies, Temple-Inland continuously creates value from its forests, whether generating forest products, enhancing wildlife habitats or protecting water quality. The company's Geographic Information System tracks detailed information about current stand conditions, including the species planted, the number of trees per acre and site productivity.

This type of information is balanced with creating stream-side and aesthetic management zones. Stream-side zones are designed to protect water quality and enhance wildlife habitats along the banks of creeks, streams and rivers. Aesthetic management zones ensure forested areas are left intact alongside highways and other appropriate locations.

Linking resources with opportunities

In recent years, purchasers of pulpwood and sawtimber have begun demanding higher quality with stricter delivery requirements. The age-old process of supplying raw material to paper mills and finished-wood operations has grown more sophisticated at company-owned and external customer facilities, and the forestry unit has responded accordingly.

New working relationships were established with logging organizations to improve efficiencies and ensure logs are being sent to specific sawmills based on identified customer requirements.

Temple-Inland is also focusing significant resources on better aligning the period in which the rate of fiber growth peaks for any given stand and the time the highest dollar value of that timber becomes available. This is a critically important initiative as the company increasingly moves beyond its own mill infrastructure and sells more to the outside marketplace. At the same time, the company can be more attentive to ecological and natural-beauty concerns with the increased control this information-management tool provides.

Further, by employing stringent quality standards and innovative in-woods chipping operations, the company is able to convert portions of trees that had been traditionally left on site, helping to maximize resources. Portable laboratories are also used to monitor the quality and dimensional uniformity of wood chips, including weight, thickness and length. By doing this, customers are assured of consistent quality, and the company is able to increase its yields through higher utilization.

When science and nature meet

Temple-Inland takes a long-term approach to maximizing both its fiber output and the sustainability of the forests—an approach that must be measured in decades, not just years or quarterly periods.

The life cycle of Temple-Inland's working forest begins in a seedling nursery, in which the company plants approximately 30 million genetically superior seedlings annually. In addition, another five million seedlings are grown for sale to private landowners. The company also contributes approximately 50,000 bald cypress trees each year to the National Tree Trust, which distributes them to communities and organizations free of charge.

During 1998, the company continued its aerial fertilization program, applying environmentally friendly nitrogen and phosphorus supplements to selected areas of its timberland to enhance fiber production.

The company supplements this traditional fertilization program with several research efforts, including "fertigation" and genetics research. Fertigation, which combines advanced fertilization and irrigation techniques, is being applied at a test site to determine the economic viability of large-scale application.

Temple-Inland's extensive forest holdings are invaluable, not just as a renewable fiber source, but as an integral and long-term part of America's landscape.

Equipped with decades of forestry experience and the most advanced technology available, the company has the ability to double pine fiber on its more intensively managed lands over a growing cycle. The key will be to continue balancing society's demand for wood and paper products with the need to perpetuate the diversity of the forest.



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Temple-Inland Facilities

Corporate Headquarters

Diboll, Texas

Subsidiary Headquarters

Inland Paperboard and Packaging, Inc.
Indianapolis, Indiana

Temple-Inland Forest Products Corporation
Diboll, Texas

Temple-Inland Financial Services Inc.
Austin, Texas

Building Products

Fiberboard Operation
Diboll, Texas

Fiber-Cement Operation
Waxahachie, Texas
(50 percent joint venture)

Gypsum Wallboard Operations
West Memphis, Arkansas
Fletcher, Oklahoma
McQueeney, Texas
(50 percent joint venture)

Lumber Operations
Rome, Georgia
DeQuincy, Louisiana
Buna, Texas
Diboll, Texas
Pineland, Texas

Medium Density Fiberboard Operations
El Dorado, Arkansas
(50 percent joint venture)
Clarion, Pennsylvania
Pembroke, Ontario, Canada

Particleboard Operations
Monroeville, Alabama
Hope, Arkansas
Thomson, Georgia
Diboll, Texas

Plywood Operation
Pineland, Texas

Paperboard Mills

Linerboard
Ontario, California
Rome, Georgia
Maysville, Kentucky
Orange, Texas

Corrugating Medium
Newport, Indiana
New Johnsonville, Tennessee

Bleached Paperboard
Evadale, Texas

Packaging Plants

Corrugated Packaging
Fort Smith, Arkansas (2)
Bell, California
El Centro, California
Ontario, California
Sante Fe Springs, California
Tracy, California
Wheat Ridge, Colorado
Orlando, Florida
Rome, Georgia
Chicago, Illinois
Crawfordsville, Indiana
Evansville, Indiana
Indianapolis, Indiana
Garden City, Kansas
Kansas City, Kansas
Louisville, Kentucky
Minden, Louisiana
Minneapolis, Minnesota
Hattiesburg, Mississippi
St. Louis, Missouri
Spotswood, New Jersey
Middletown, Ohio
Streetsboro, Ohio
Biglerville, Pennsylvania
Hazleton, Pennsylvania
Lexington, South Carolina
Rock Hill, South Carolina
Elizabethton, Tennessee (2)
Nashville, Tennessee
Dallas, Texas
Edinburg, Texas
Petersburg, Virginia (2)
Vega Alta, Puerto Rico
Buenos Aires, Argentina
Santiago, Chile
San Jose Iturbide, Guanajuato, Mexico
Monterrey, Leon, Mexico
Los Mochis, Sinaloa, Mexico

Consumer Packaging
Buena Park, California
Ontario, California
Sante Fe Springs, California (2)
(Crockett Container Corporation)
Harrington, Delaware
Indianapolis, Indiana
Leominster, Massachusetts
Rural Hall, North Carolina

Financial Services

Consumer Banking Regions
Central Valley of California
Austin, Texas, and Adjacent Cities
Dallas, Texas, and Adjacent Cities
East Texas
Houston, Texas, and Adjacent Cities
San Antonio, Texas, and Adjacent Cities

Mortgage Banking Operations
Arizona
Arkansas
California
Colorado
Florida
Illinois
Kansas
Louisiana
Massachusetts
Michigan
Minnesota
Missouri
Montana
Nevada
New Jersey
New York
North Carolina
Ohio
Oklahoma
Oregon
Pennsylvania
South Dakota
Texas
Washington
Wisconsin

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Management's Discussion and Analysis

Of Financial Condition and Results of Operations

Results of operations, including information regarding the principal business segments, are shown below.

BUSINESS SEGMENTS

For the year *(in millions)*	**1998**	1997	1996	1995	1994	1993	1992	1991	1990	1989
REVENUES										
Paper	**$2,018**	$2,063	$2,082	$2,198	$1,740	$1,572	$1,610	$1,519	$1,517	$1,506
Building products	**613**	617	563	533	575	497	409	311	305	320
Other activities	**—**	—	—	—	20	58	77	68	70	68
Manufacturing net sales	**2,631**	2,680	2,645	2,731	2,335	2,127	2,096	1,898	1,892	1,894
Financial services	**1,109**	945	815	764	632	635	638	609	509[b]	49
Total revenues	**$3,740**	$3,625	$3,460	$3,495	$2,967	$2,762	$2,734	$ 2,507	$2,401	$1,943
INCOME BEFORE TAXES										
Paper	**$ 33**	$ (39)	$ 113	$ 357	$ 74	$ 6	$ 135	$ 156	$ 250	$ 323
Building products	**112**	131	102	67	139	102	40	5	9	24
Other activities	**—**	—	—	—	1	(2)	(2)	1	(2)	(1)
	145	92	215	424	214	106	173	162	257	346
Financial services	**154**	132	63[a]	98	56	68	64	54	52[b]	(2)
Segment operating income	**299**	224	278	522	270	174	237	216	309	344
Corporate expense	**(28)**	(25)	(17)	(22)	(14)	(11)	(15)	(16)	(21)	(13)
Special charge	**(47)**	—	—	—	—	—	—	—	—	—
Parent Company interest - net	**(106)**	(110)	(110)	(73)	(67)	(69)	(48)	(38)	(26)	(26)
Other income	**6**	6	5	4	4	2	3	5	7	7
Income before taxes	**$ 124**	$ 95	$ 156	$ 431	$ 193	$ 96	$ 177	$ 167	$ 269	$ 312

[a] *Includes a one-time assessment of $44 million to recapitalize the Savings Association Insurance Fund (SAIF).*
[b] *Includes operating results from the consolidation of Guaranty Federal Bank, F.S.B., beginning January 1, 1990.*



David H. Dolben
Vice President and Chief Accounting Officer, Temple-Inland Inc.



M. Richard Warner
Vice President, General Counsel and Secretary, Temple-Inland Inc.

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Paper

The Paper Group is composed of two operations: corrugated packaging and bleached paperboard. The following table provides information on the operating earnings of this group, excluding the impact of the special charges discussed below.

For the year	**1998**	1997	1996
(in millions)			
Corrugated packaging	**$ 100.0**	$ (11.0)	$ 165.6
Bleached paperboard	**(6.4)**	15.3	(8.2)
Group administration	**(61.1)**	(43.3)	(44.4)
Operating earnings	**$ 32.5**	$ (39.0)	$ 113.0

CORRUGATED PACKAGING

The corrugated packaging operation manufactures linerboard and corrugating medium at six mills and converts it into corrugated shipping containers at 41 corrugated packaging plants located throughout the United States, Puerto Rico, Mexico and South America. In addition, it operates eight specialty converting plants. Operation of the Newark, California, mill and box plant was discontinued in May 1998, and the assets of the Rexford Paper Division were sold in October 1998. Operation of the Erie, Pennsylvania, box plant was discontinued in the second half of 1997. During 1997, two state-of-the-art corrugated packaging plants began operations – one in Sinaloa, Mexico, the other in Streetsboro, Ohio.

Early in 1998, the corrugated packaging operation undertook a broad-based study of how to reduce its costs and improve margins. The outgrowth of these efforts, formally referred to as **M***plus* **50**, is an intensive program designed to decrease total cost of goods sold, boost revenues and increase organizational efficiency and effectiveness. As part of this program, this operation will measure individual business unit – instead of total system – profitability and streamline administrative support functions, while providing better management of information through improved technology. Layers of management will be reduced and some manufacturing assets will be displaced. This operation will also focus on margin improvement by targeting a more select customer base as part of this program.

A number of actions triggered by this study resulted in a special fourth quarter 1998 charge that included $13 million in severance costs and write-offs of $4.5 million of abandoned packaging assets. These initiatives, combined with a review of the South American earnings prospects in light of the Brazilian economic turmoil and competitive pricing environment, indicated the need for a $20 million impairment write-down of the South American operations that was also recorded in the fourth quarter of 1998. The operation is committed to achieving profitable operations in South America. Otherwise, this operation will consider other alternatives, including liquidating these investments.

Before group administrative costs and the nonrecurring items discussed above, the corrugated packaging operation had earnings of $100.0 million in 1998, compared with a loss of $11.0 million in 1997. Revenues for this operation decreased 3 percent in 1998, compared with 1997. Unit sales declined by 9 percent, more than offsetting the positive effect on revenues of improved prices. Revenues for 1997 were down 4 percent compared with 1996, reflecting the effect of a decline in prices and an improvement in volume.

Box prices in 1997 declined an average of 11 percent, following a 19 percent decline in 1996. Prices, however, improved in the latter half of 1997 and early 1998, but started retreating in the third quarter of 1998, ending the year near beginning-of-year levels. For the year, average 1998 box prices were 7 percent higher than 1997 prices.

Tons of boxes sold were down 3 percent in 1998, compared with an increase of 4 percent in 1997. This reduced growth rate was a product of both slower industry growth and the corrugated packaging operation's strategy to improve margins by exiting some low-margin business.

The average cost of old corrugated containers (OCC), the principal raw material used in approximately 46 percent of the group's containerboard production, declined by $16 per ton in 1998 after having increased by $16 per ton in 1997.

As indicated in the table below, mill production totaled 2,499,000 tons in 1998, a 262,000-ton decrease in production from 1997, of which 47,000 tons related to the permanent closure of the Newark, California, corrugating medium mill. Production of containerboard exceeded internal plant usage by 152,000 tons in 1998, 336,000 tons in 1997 and 275,000 tons in 1996. Excess production was sold in the domestic and export markets. The company curtailed production by approximately 236,000 tons in 1998, 36,000 tons in 1997 and 120,000 tons in 1996, to control inventory levels.

For the year	**1998**	1997	1996
MILL PRODUCTION			
(in tons)	**2,499,000**	2,761,000	2,577,000

Board consumption at the Mexican, Puerto Rican and South American converting facilities increased by 21,000 tons to 195,000 tons in 1998. While volumes increased in Chile, Argentina and Sinaloa, Mexico, competitive pricing pressures contributed to continued operating losses at these plants. The operations of the other two Mexican plants, located in Guanajuato and Monterrey, continued to be profitable in 1998.

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The following table shows the quarterly sales of the corrugated packaging operation in tons and dollars. The totals presented include not only boxes sold, but also open market sales of linerboard and related products.

CORRUGATED PACKAGING

For the year	**1998**	1997	1996
UNIT SALES *(in thousands of tons)*			
1st Quarter	**662**	647	575
2nd Quarter	**628**	719	608
3rd Quarter	**616**	706	636
4th Quarter	**613**	697	616
	2,519	2,769	2,435
NET SALES *(in millions)*			
1st Quarter	**$ 431.8**	$ 411.9	$ 469.7
2nd Quarter	**419.5**	432.6	453.4
3rd Quarter	**410.4**	421.3	423.3
4th Quarter	**379.8**	428.2	414.2
	$1,641.5	$1,694.0	$1,760.6

In 1998, the company sold the operating assets of its Rexford Paper Division at a small profit. Rexford had revenues of $15.2 million in 1998, $20.5 million in 1997, and $21.6 million in 1996. Also in 1998, the Newark, California, mill and box plant were closed. These closures only nominally affected revenues and earnings because the majority of the business was transferred to other operations of the group.

In October 1997, the company sold substantially all of the operating assets of its subsidiary, Temple-Inland Food Service Corporation (Food Service), for approximately book value. Food Service had revenues of $66.3 million and $84.1 million during 1997 and 1996, respectively.

BLEACHED PAPERBOARD

The bleached paperboard operation manufactures bleached paperboard at one mill in Evadale, Texas. Its products are sold to commercial printers and paperboard converters, including those serving packaging, food service and office product markets.

Before group administrative costs, the bleached paperboard operation reported a loss of $6.4 million in 1998, compared with income of $15.3 million in 1997. Average prices for bleached paperboard declined by 4 percent in 1998, compared with 1997, after having been flat the prior year. Paperboard sales volume declined by 2 percent in 1998 versus 1997, after having improved by 21 percent in 1997. Production in both 1998 and 1997 was limited to control inventory levels.

The earnings deterioration in 1998 was a direct result of the 4 percent decline in selling price and, to a lesser extent, the decline in volume. The earnings improvement in 1997 resulted primarily from the improved volume together with manufacturing costs being below 1996 levels by $16 per ton as a result of cost-reduction programs.

The following table lists the quarterly sales of the bleached paperboard operation in tons and dollars. Changes in product mix from period to period may make historical comparisons difficult.

BLEACHED PAPERBOARD

For the year	**1998**	1997	1996
UNIT SALES *(in thousands of tons)*			
PAPERBOARD			
1st Quarter	**158**	155	108
2nd Quarter	**158**	178	125
3rd Quarter	**168**	169	149
4th Quarter	**139**	133	142
	623	635	524
PULP	**—**	2	100
NET SALES *(in millions)*			
PAPERBOARD			
1st Quarter	**$ 95.9**	$ 87.6	$ 66.1
2nd Quarter	**95.8**	95.0	73.6
3rd Quarter	**102.0**	96.9	83.3
4th Quarter	**82.4**	86.5	77.5
	$ 376.1	$ 366.0	$ 300.5
PULP AND OTHER	**$ —**	$ 2.9	$ 21.2

GROUP ADMINISTRATION

The Paper Group's administrative costs were up by $17.8 million in 1998 compared with 1997, after having declined in 1997 by $1.1 million from 1996 levels. The 1998 increase was largely related to consulting and internal costs related to the company's margin-enhancement initiative and efforts related to Year 2000 compliance.

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Building Products

The Building Products Group manufactures a diversified line of construction and commercial-grade building materials at 17 facilities (including three joint-venture facilities and two medium density fiberboard [MDF] facilities acquired September 30, 1998). In 1998, approximately 81 percent of its revenues were generated from wood-based materials or log residues. These products, sold to both residential and commercial market segments, include lumber, plywood, particleboard, medium density fiberboard and fiberboard. The non-wood-based business unit manufactures a variety of gypsum wallboard products that are sold to the same market segments as wood-based materials.

Excluding the special charges discussed below, the group earned $112 million in 1998, the third-highest earnings level in its history, following 1994's record earnings of $139 million and 1997's earnings of $131 million. Net manufacturing revenues in 1998 decreased $4.3 million, less than 1 percent from 1997. This slight decrease followed a 10 percent increase in 1997 over 1996. As a result of improved residential and commercial construction levels, prices advanced in 1998 across all product lines, except for fiberboard and lumber.

The following table provides information on unit sales volumes and net sales for each business unit.

BUILDING PRODUCTS

For the year	**1998**	1997	1996
UNIT SALES*			
Pine lumber	**603**	639	605
Fiber products	**423**	402	457
Particleboard	**518**	470	399
Plywood	**289**	281	259
Gypsum wallboard	**858**	843	838
Medium density fiberboard	**35**	—	—
NET SALES *(in millions)*			
Pine lumber	**$ 222.7**	$ 262.1	$ 217.4
Fiber products	**64.4**	66.2	73.3
Particleboard	**141.5**	125.0	112.2
Plywood	**59.6**	55.2	52.1
Gypsum wallboard	**115.5**	104.6	90.2
Medium density fiberboard	**9.3**	—	—
Retail distribution	**—**	4.2	17.1
Other	**—**	—	0.3
	$ 613.0	$ 617.3	$ 562.6

**Unit sales amounts shown are in millions of square feet, except pine lumber which is in millions of board feet.*

Pine lumber shipments of 603 million board feet decreased 5.6 percent from 1997. Two major modernization projects, one at the Buna, Texas, sawmill and the other at the Diboll, Texas, sawmill, resulted in temporary production outages and reduced shipments. The modernization resulted in the abandonment of $3.4 million of machinery and equipment at the Diboll sawmill that is included in the special charge. Both plants should return to full capacity by the middle of 1999.

In keeping with its focus of maximizing the value of its timber holdings through conversion to high-value products, the Building Products Group decided to cease plywood production at the Pineland complex and add a state-of-the-art sawmill. This will allow the group to optimize the use of available sawtimber and result in an improved return on its timberland assets. As a result, the company recorded a write-down of $6.5 million related to certain plywood assets.

Economic recession in the Far East forced West Coast lumber producers to reduce exports and market additional products in North America. This created an oversupply in the industry and, as a result, lumber prices were negatively affected. Although first quarter lumber prices were only 1 percent below those experienced in the first quarter of 1997, second quarter prices were down 13.6 percent, third quarter prices were down 18.9 percent, and fourth quarter prices were down 9.3 percent from previous year levels. The average selling price for the year was down 10 percent from 1997.

Fiber products revenues decreased $1.8 million, or 3 percent, from 1997 despite a 5 percent increase in shipments. Weaker demand due to competition from other products led to lower pricing. Average prices for all fiber products were 7 percent lower than 1997 levels. TrimCraft™, the company's alternative lumber trim product, continued to gain market acceptance and shipments of the product were 28 percent higher than 1997 levels.

During 1998, construction continued on a new joint-venture fiber-cement plant in Waxahachie, Texas. The $60 million facility is designed to produce 126 million square feet of fiber-cement products annually. This state-of-the-art facility will offer a full line of fiber-cement products marketed under the trade name FORTRA™, to be used by builders as siding, soffit, trim, tile backer and a variety of other applications. Fiber-cement siding is a weather-stable product with increasing acceptance in the marketplace.

During 1998, construction was completed on the MDF plant in El Dorado, Arkansas. The $97 million facility, a joint-venture operation, is designed to produce 150 million square feet of MDF annually. Production began in May and the facility was still operating in the start-up phase at year end, producing only 41 percent of capacity during the last quarter of the year. This mill is anticipated to operate at almost 90 percent of capacity during 1999. MDF products are high-grade composite panels that serve as a suitable alternative to high-quality millwork lumber and as flooring substrates.

The Building Products Group purchased two MDF facilities from MacMillan Bloedel Limited in September 1998, located in Clarion, Pennsylvania, and Pembroke, Ontario, Canada. Each of these facilities has a continuous press and the design capacity to produce approximately 130 million square feet of MDF annually. Each of these mills is currently producing at less than design capacity, but should attain these levels by year end. The company's three MDF plants will be capable of supplying a major share of the growing thin MDF market due to their continuous press capabilities.

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Using by-products of lumber processing, the group manufactures particleboard at four plants in Texas, Alabama, Arkansas and Georgia. The Texas and Georgia facilities experienced lost production in 1997 due to ten-week shutdowns for modernization, but were back to normal production in 1998. As a result, particleboard shipments increased 10 percent over 1997. The group also experienced an increase in the sales average for the year due to an improved product mix. Due to the increase in shipments and sales averages, revenues from particleboard rose $16.5 million, or 13 percent, from 1997. In 1997, shipments were 18 percent above, and prices were 6 percent below, 1996 levels.

Record earnings were achieved by the group's gypsum wallboard operations in 1998 as prices continued the recovery that began in 1994 and the mix of products manufactured continued to improve. Gypsum wallboard shipments of 858 million square feet were only slightly above 1997 levels, but revenues increased by $10.9 million due to an 8.5 percent increase in sales averages for the year. While gypsum wallboard demand improved in both 1996 and 1997, 1998 was a year of record demand levels as capacity utilization ratios reached 99 percent for the year. This dictated operating in a managed distribution environment for most of the year. In addition to a strong market, specialty products, including the group's Stretch 54® product, pre-sized to reduce material waste and application labor in houses with nine-foot-high ceilings, sustained its market share in 1998. Specialty panels in 1998 accounted for 39 percent of total shipments, compared with 40 percent in 1997.

In 1998, construction began on the gypsum wallboard plant in Cumberland City, Tennessee. The plant will operate under the Standard Gypsum LLC joint venture, an equal partnership with Caraustar Industries, Inc. This state-of-the-art facility is expected to produce in excess of 700 million square feet of gypsum wallboard annually and will utilize 100 percent flue gas desulphurization (synthetic) gypsum. This plant is being constructed adjacent to the Cumberland Fossil Plant, the Tennessee Valley Authority's (TVA) largest coal-fired steam electric plant, which will supply 100 percent of the synthetic gypsum for use in the production of the wallboard at this facility. The synthetic gypsum is produced as a by-product of the TVA plant's air cleaning system. Construction of this $60 million facility was about 40 percent complete at the end of 1998, and production is expected to begin during the third quarter of 1999.

TIMBER AND TIMBERLANDS

The company controls approximately 2.2 million acres of timberland in Texas, Louisiana, Georgia and Alabama. In 1998, this renewable resource provided approximately 63 percent of the pine fiber requirements necessary to operate the company's paper and solid wood converting operations.

Financial Services

The company's Financial Services Group includes savings bank, mortgage banking, real estate development and insurance operations. The following selected financial information provides a detailed description of these operations.

FINANCIAL SERVICES GROUP
SELECTED FINANCIAL INFORMATION

For the year or at year end	**1998**	1997	1996
(in millions)			
INCOME			
Savings bank	**$ 113.5**	$ 106.6	$ 37.5[b]
Mortgage banking	**21.8**	24.0	23.0
Real estate	**13.2**[a]	(3.4)	(1.7)
Insurance	**5.6**	4.8	4.3
Income before taxes	**154.1**	132.0	63.1
Taxes on income	**26.9**	20.6	24.3
Net income	**$ 127.2**	$ 111.4	$ 38.8
ASSETS			
Savings bank	**$ 11,947.4**	$ 10,370.6	$ 8,945.9
Mortgage banking	**441.9**	385.6	241.4
Real estate	**319.2**	280.4	287.4
Insurance	**31.9**	32.4	26.3
Other activities	**—**	—	0.1
Eliminations	**(340.8)**	(284.3)	(166.0)
Total assets	**$ 12,399.6**	$ 10,784.7	$ 9,335.1
LIABILITIES			
Savings bank	**$ 11,163.9**	$ 9,798.1	$ 8,509.9
Mortgage banking	**358.0**	303.4	177.1
Real estate	**270.8**	222.0	204.7
Insurance	**14.5**	19.7	17.7
Other activities	**—**	—	(0.1)
Preferred stock issued by subsidiary	**225.1**	150.0	—
Eliminations	**(340.8)**	(284.3)	(166.0)
Total liabilities	**$ 11,691.5**	$ 10,208.9	$ 8,743.3
EQUITY			
Savings bank	**$ 558.4**	$ 422.5	$ 436.0
Mortgage banking	**83.9**	82.2	64.3
Real estate	**48.4**	58.4	82.7
Insurance	**17.4**	12.7	8.6
Other activities	**—**	—	0.2
Total equity	**$ 708.1**	$ 575.8	$ 591.8

[a] *Includes $10.0 million gain from sale of an investment property.*
[b] *Includes a one-time SAIF assessment of $43.9 million.*

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SAVINGS BANK

The company's savings bank, Guaranty Federal Bank, F.S.B. (Guaranty), conducts its business through 135 banking centers in Texas and California. The Texas operations are concentrated in the metropolitan areas of Houston, Dallas/Fort Worth, San Antonio and Austin, as well as the central and eastern regions of the state. All of Guaranty's branch locations in California are in the Central Valley area. The primary business of Guaranty is to attract savings deposits from the general public, to invest in single-family adjustable-rate mortgages, to be a major construction lender to the commercial and residential real estate industry, and to provide a variety of loan products to consumers and businesses.

GUARANTY FEDERAL BANK, F.S.B. SELECTED FINANCIAL INFORMATION

For the year	**1998**	1997	1996
(dollars in millions)			
INCOME AND EXPENSE			
Net interest income	**$ 245.3**	$ 222.3	$ 193.0
Noninterest income	**30.4**	17.8	22.2
Noninterest expense	**148.6**	128.5	163.9[a]
Minority interest in income of subsidiary	**13.8**	6.5	—
Income before taxes	**113.3**	106.6	37.5
AVERAGE BALANCE SHEET			
Total earning assets	**10,389.9**	9,919.1	8,889.0
Loans receivable and mortgage loans held for sale	**7,440.4**	6,530.9	5,215.1
Mortgage-backed and investment securities	**2,601.8**	2,721.6	3,204.3
Deposits	**7,579.3**	7,090.5	6,423.9
Securities sold under repurchase agreements and FHLB advances	**2,241.5**	2,573.9	2,113.5
KEY RATIOS			
Yield on earning assets	**7.02%**	7.06%	6.96%
Cost of funds	**4.82%**	4.95%	4.91%
Net interest spread	**2.20%**	2.11%	2.05%

[a]*Includes a one-time SAIF assessment of $43.9 million.*

At year end 1998, loans receivable constituted 81 percent of earning assets, compared with 71 percent in the prior year. During 1998, Guaranty continued to securitize portions of its mortgage loans held in its portfolio. At year end 1998, the ratio of loans receivable to earning assets, with the inclusion of the balance of $657 million in loans securitized, was 87 percent.

Net interest income for 1998 increased $23.0 million from 1997, due primarily to the growth of net earning assets. Net interest income for 1997 increased $29.3 million from 1996. This was a result of an increase in average earning assets of $1 billion above 1996, principally due to the acquisition of Stockton Savings Bank, F.S.B. (SSB) discussed below, combined with the improved asset mix of loans.

When new loans are originated, an estimated allowance for losses is provided. Thereafter, this provision is adjusted for actual net charge-off experience and other factors. In 1998, despite overall loan portfolio growth, the allowance for loan losses as a percentage of loans receivable decreased from 1.41 percent to 1.06 percent, or 24 percent from 1997. The decrease was driven primarily by a 30 percent decline in the purchased loan portfolios over the same period and the reduction in the related allowances for those loans, as losses were less than anticipated. In 1997, the allowance for loan losses as a percentage of loans receivable increased from 1.26 percent to 1.41 percent, or 11 percent from 1996, principally due to the acquisition of SSB. The provision for loan loss decreased $15.5 million during 1997, compared with 1996, primarily related to the securitization of approximately $1 billion of mortgage loans, payoff of other notes and favorable net charge-off experience.

Management periodically reviews and adjusts pass loan loss factors in response to historical net charge-off experience. The commercial real estate portfolios currently have pass loan loss factors that exceed the historical loss experience. This results from these loans being relatively new and, as a result, they have not reached the state where charge-offs would have been recorded for a seasoned loan portfolio.

Noninterest income primarily includes fees collected, including service charges on deposits. In 1997, losses on the sale of certain loans and mortgage securities resulted in a net noninterest income reduction of $4.4 million from 1996. In 1998, net noninterest income increased $12.6 million from 1997 primarily because similar loan and security sales did not recur and Guaranty sold certain assets resulting in gains.

Noninterest expense for 1998 increased $20.1 million from 1997 primarily as the result of the new operations in California from the SSB acquisition and the related increase in compensation and benefits. Excluding $43.9 million related to the 1996 one-time Savings Association Insurance Fund (SAIF) assessment discussed below, noninterest expense for 1997 increased $8.5 million from 1996, which is also a result of the increased California operations, offset by reduced insurance premiums on deposits as a result of the SAIF recapitalization.

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BIF/SAIF Legislation

On September 30, 1996, President William J. Clinton signed the Economic Growth and Regulatory Paperwork Reduction Act of 1996 (the Act). Among its many provisions, the Act provided for (i) the recapitalization of the SAIF to an amount sufficient to increase the SAIF's net worth to 1.25 percent of SAIF insured deposits, (ii) the reduction of SAIF insurance assessments to parity with those of the Bank Insurance Fund (BIF), and (iii) the eventual merger of the SAIF and BIF. Specifically, the statute required a one-time special assessment of SAIF members, calculated at 65.7 basis points of insured deposits, or $43.9 million for Guaranty.

Effective January 1, 1997, Guaranty was not required to pay any deposit insurance assessments, but is required to pay approximately 6.5 basis points on its insured deposits annually to repay interest on certain Financial Corporation (FICO) bond obligations. Prior to the special assessment, Guaranty was paying 23 basis points of insured deposits for insurance premiums.

Acquisitions

On November 14, 1998, the company signed a definitive merger agreement to acquire all of the outstanding stock of HF Bancorp, Inc., for $18.50 per share. Total assets of HF Bancorp, Inc., the majority of which are held by its subsidiary, Hemet Federal Savings & Loan Association (Hemet), are approximately $1 billion and consist primarily of residential, consumer and construction loans, mortgage-backed securities and short-term investments. Hemet operates 18 branches in the Southern California markets of Riverside County, Palm Springs and Northern San Diego County. The purchase price of $118 million will consist of either all cash or a combination of company common stock and cash and is to be accounted for as a purchase business combination. The transaction, subject to the approval of regulatory authorities and HF Bancorp, Inc. shareholders, is anticipated to close during the second quarter of 1999.

On June 27, 1997, the company acquired all of the outstanding stock of California Financial Holding Company, the parent company of SSB, and merged the operations of SSB into Guaranty. The consideration for the transaction was $143.4 million, consisting of approximately 1,614,000 shares of Temple-Inland Inc. common stock and cash of $47.3 million. SSB operated 25 banking centers in the Central Valley area of California and had assets at acquisition totaling approximately $1.4 billion, consisting primarily of loans and securities.

Liquidity, Interest Rate Risk Management and Capital

Guaranty is required by the Office of Thrift Supervision (OTS) to maintain average daily balances of statutorily defined liquid assets. During 1997, the liquid assets requirement was decreased from 5 percent to 4 percent of net withdrawable deposits and short-term borrowings.

The operations of Guaranty are subject to a risk of interest rate fluctuation to the extent that interest-earning assets and interest-bearing liabilities mature or reprice at different times or in differing amounts. Because approximately 91 percent of Guaranty's assets at year end 1998 have adjustable rates, this risk is significantly mitigated.

Guaranty is also subject to prepayment risk inherent in a portion of its single-family adjustable-rate mortgage assets. A substantial portion of Guaranty's investments in adjustable-rate mortgage-backed securities have annual or lifetime caps that subject Guaranty to interest rate risk should rates rise above certain levels. To optimize net interest income while maintaining acceptable levels of interest rate and liquidity risk, Guaranty, from time to time, will enter into various interest rate contracts for purposes other than trading.

On May 28, 1997, a newly formed subsidiary of Guaranty, which qualifies as a real estate investment trust (REIT), issued $150 million of noncumulative floating-rate preferred stock in a private placement. The preferred stock qualifies for inclusion in regulatory capital, subject to certain limitations. The REIT issued an additional $75 million of noncumulative floating-rate preferred stock on May 28, 1998.

OTS regulations require savings institutions to maintain certain minimum levels of capital. Guaranty's regulatory capital exceeded all applicable capital requirements at year end 1998. Because of loan growth experienced by Guaranty in 1998, changes in asset mix in Guaranty's balance sheet and prospective changes in Guaranty's risk-based capital calculation, Guaranty expects an increase in its capital requirements. As a result, the company expects to increase capital in Guaranty by up to $160 million in order to maintain its classification of "well capitalized" under OTS regulations. Note L on page 53 contains additional information concerning Guaranty's capital requirements.

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MORTGAGE BANKING

Mortgage banking is conducted through Temple-Inland Mortgage Corporation (TIMC), which arranges financing of single-family mortgage loans, then sells the loans in the secondary market (primarily FNMA, FHLMC and GNMA securities). TIMC generally retains the servicing of these loans.

A summary of selected financial information is provided below.

MORTGAGE BANKING OPERATIONS SUMMARY

For the year	**1998**	1997	1996
(dollars in millions)			
Revenues	**$ 226**	$ 136	$ 95
Income before taxes	**22**	24	23
PORTFOLIO ROLL-FORWARD *(Including loans serviced for affiliates)*			
Beginning servicing	**$26,082**	$ 17,851	$ 13,460
Purchased servicing	**3,536**	9,497	4,888
New loans added, net of flow releases	**3,375**	2,600	2,265
Portfolio releases	**(3,210)**	—	—
Run-off	**(6,897)**	(3,866)	(2,762)
Ending servicing	**$22,886**	$ 26,082	$ 17,851
Portfolio growth rate	**(12.3)%**	46.1%	32.6%
Run-off factor	**28.9%**	16.8%	15.9%
Ending number of loans serviced	**256,300**	351,600	225,700

Mortgage loan originations increased to a record $6 billion in 1998, almost double the volume in 1997. Portfolio run-off accelerated from 16.8 percent in 1997 to 28.9 percent in 1998. In order to reduce exposure to accelerated prepayments, the servicing rights of approximately $4.5 billion ($1.3 billion of which was not transferred until 1999) of primarily seasoned and relatively high-rate loans were sold during 1998 to third parties resulting in gains of $27.6 million. At year end 1998, the reserve for impairment of the servicing portfolio was $16.8 million. No reserve for impairment was required in 1997 and 1996.

Acquisitions of servicing totaled $3.5 billion in 1998. Overall, the servicing portfolio declined in 1998 by $3.2 billion to $22.9 billion. Servicing totaling $9.5 billion was acquired during 1997, of which $6.4 billion was associated with the acquisition of Knutson Mortgage Corporation (KMC). Servicing totaling $4.9 billion was acquired during 1996, a portion of which was acquired subject to a call option. At the end of 1998, $1 billion of the servicing portfolio was subject to the call option. The call option price, if exercised, would exceed the carrying value.

REAL ESTATE GROUP

Real estate operations conducted by Lumbermen's Investment Corporation include development of residential subdivisions as well as management and sale of income properties. Land development projects include 38 residential subdivisions in Texas, Arizona, California, Colorado, Florida, Georgia, Missouri, Tennessee and Utah. At the end of 1998, land development inventory included 1,401 residential lots (1,175 under contract), 1,803 lots under development and 5,721 acres of land. Lot sales for 1998 were 1,594, compared with 1,422 in 1997 and 1,082 in 1996.

Commercial income, shown in the table below, includes a $10 million gain in 1998 from the sale of a commercial investment property. The company owns 18 commercial properties, including two hotels, one retail center, two business parks, five parcels of commercial land, and properties owned through joint-venture interests.

Selected financial information related to these activities is shown below.

REAL ESTATE GROUP OPERATIONS SUMMARY

For the year	**1998**	1997	1996
(in millions)			
REVENUES			
Residential	**$ 58.4**	$ 43.4	$ 35.9
Commercial	**45.7**	21.4	18.2
Interest and other	**3.2**	3.7	7.0
Total	**$ 107.3**	$ 68.5	$ 61.1
INCOME (LOSS) BEFORE TAXES			
Residential	**$ 8.9**	$ 2.2	$ 3.0
Commercial	**19.0**	4.5	2.2
Interest and other	**(14.7)**	(10.1)	(6.9)
Total	**$ 13.2**	$ (3.4)	$ (1.7)

INSURANCE

Timberline Insurance Managers, Inc. (Timberline), one of the largest insurance agencies in Texas, operates as a general agency selling a full range of insurance products, including automobile, homeowners and business insurance, as well as annuities and life and health products. The agency also acts as the risk management department of the company. Timberline currently has offices in Austin, Houston, Dallas-Fort Worth, El Paso and San Antonio, Texas.

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A summary of revenues and income before taxes is shown below.

INSURANCE OPERATIONS SUMMARY

For the year *(in millions)*	**1998**	1997	1996
REVENUES	**$ 33.5**	$ 30.4	$ 24.9
INCOME BEFORE TAXES	**5.6**	4.8	4.3

ENVIRONMENTAL MATTERS

The company is committed to protecting the health and welfare of its employees, the public and the environment, and strives to maintain compliance with all state and federal environmental regulations in a cost-effective manner. In the construction of new facilities and the modernization of existing facilities, the company installed state-of-the-art technology for controlling air and water emissions. These forward-looking programs should minimize the impact that changing regulations have on capital expenditures for environmental compliance.

Future expenditures for environmental control facilities will depend on changing laws and regulations and technological advances. Given these uncertainties, the company estimates that capital expenditures for environmental purposes during the period 1999 through 2001 will average $17 million each year, exclusive of the expenditures for the Cluster Rule compliance discussed below.

On November 14, 1997, the U.S. Environmental Protection Agency (the EPA) issued extensive regulations governing air and water emissions from the pulp and paper industry (the Cluster Rule). According to the EPA, the technology standards in the Cluster Rule will cut the industry's toxic air pollutant emissions by almost 60 percent from current levels and virtually eliminate all dioxin discharged from pulp, paper and paperboard mills into rivers and other surface waters. The Cluster Rule also provides incentives for individual mills to adopt technologies that will lead to further reductions in toxic pollutant discharges.

The EPA estimates that the industry will need to invest approximately $1.8 billion in capital expenditures and approximately $277 million per year in operating expenditures to comply with the Cluster Rule. All persons subject to the Cluster Rule, including the company, must be in compliance with the initial requirements by April 15, 2001. The estimated expenditures disclosed above do not include expenditures that may be needed to comply with the Cluster Rule. Based upon its interpretation of the Cluster Rule as issued, the company currently estimates that compliance with the Cluster Rule may require modifications at several facilities. Some of these modifications can be included in modernization projects that will provide economic benefits to the company. Excluding these investments, environmental expenditures are not expected to exceed $110 million over the next three years.

CAPITAL RESOURCES AND LIQUIDITY

The company's financial condition continues to be strong. Internally generated funds, existing credit facilities and the capacity to issue long-term debt are sufficient to fund projected capital expenditures, service existing debt, pay dividends and meet normal working capital requirements. See Note 10 on pages 65 and 66 for a summary of capital expenditures for years 1998, 1997 and 1996. Capital expenditures of approximately $300 million are projected for 1999.

Net interest expense incurred by the Parent Company is shown below.

For the year *(in millions)*	**1998**	1997	1996
PARENT COMPANY INTEREST - NET			
Interest expense	**$ 107.5**	$ 112.3	$ 112.9
Capitalized interest	**(1.5)**	(2.0)	(3.3)
Interest expense - net	**$ 106.0**	$ 110.3	$ 109.6

Interest expense decreased from $112.3 million to $107.5 million in 1998, primarily as a result of lower average rates. During 1998, $90.0 million of notes payable, with interest rates averaging approximately 9 percent, and private placement debt of $80.0 million, with interest rates averaging 7 percent, were paid off and replaced with commercial paper and short-term borrowings with interest rates averaging 5.77 percent at year end 1998. Parent Company interest paid during 1998, 1997 and 1996 was $100.6 million, $104.5 million and $105.9 million, respectively.

In June 1998, the company filed a shelf registration statement registering the issuance of $500 million of its medium-term notes, Series F. The company issued approximately $300 million of these medium-term notes during the first quarter of 1999. The issued notes have a 10-year term and bear interest at approximately 6.8 percent per annum. Proceeds from the notes will be used to refund approximately $70 million of existing senior debt maturing in 1999, and to fund the cash portion of the purchase price in the Hemet transaction and the capital contribution the company will make to Guaranty.

In August 1995, the Board of Directors approved a stock repurchase program allowing the company to repurchase up to 2.5 million shares. In May 1998, the Board of Directors increased the stock repurchase program by an additional 2.5 million shares. At year end 1998, 2,718,400 shares had been repurchased under this program.

INCOME TAXES

The company's effective tax rate for the years 1998 and 1997 was 46 percent. The difference in the statutory rate and annual effective tax rate was primarily attributable to losses in foreign operations for which no financial benefit was recognized, and on non-deductible goodwill associated with prior years' acquisitions.

The Internal Revenue Service is examining the company's consolidated tax returns for the years 1987 through 1992. The resolution of these examinations is not expected to have a significant impact on the company's financial condition or results of operations.

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YEAR 2000 COMPLIANCE

The company's three lines of business, the Paper, Building Products and Financial Services Groups, are dependent upon computer technology and programs for conducting business. Each line of business has been working for the past two years to ensure that the Year 2000 has no significant effect on its information, financial and manufacturing systems.

To date, the company has spent $6.7 million on Year 2000 compliance and estimates the total spending will be approximately $13.0 million. These costs are being expensed as incurred and are not expected to have a material impact on the company's financial position.

Year 2000 readiness for the operations in the Financial Services Group is subject to review and oversight of various regulatory agencies. All critical systems have completed testing and implementation will be completed by June 30, 1999. The critical systems are those that service its portfolio of loans, mortgages and customer deposits. Based upon project progress, the company is confident all regulatory requirements will be met and that any Year 2000 disruption is unlikely. If any disruption were to occur that significantly affected operations or customer service, the group would implement its disaster recovery contingency plans.

The Paper and Building Products Groups have found few instances of date-dependent information within their manufacturing processes. There is no indication at this time that production could be affected by date-required fields that cannot be overridden or entered manually.

A potential risk is that an external provider could have a Year 2000 related problem that would affect the ability of the company to manufacture its products or serve its customers. For instance, should a utility provider not be able to supply power needs to a facility, some impact to normal operations would be expected. Larger facilities with self-power generation would be able to continue operations with a decline in production rates until outside power is restored. The company has the flexibility to produce products in multiple geographic locations, which allows for scheduling production and shipping from alternate locations should disruptions occur.

Communications with these and other suppliers are ongoing to assess the risk to the organization and identify the company's exposure to such outside influences. The company has not identified any such risk at this time.

No interruption of services is expected within the administrative support systems. Most software for meeting business needs is purchased and Year 2000 modifications and testing is performed by the supplier. The company also tests these purchased systems for Year 2000 readiness.

While there can be no guarantee that Year 2000 problems will not occur, the company believes its efforts have addressed the risks and that contingency plans are in place for the unexpected.

NEW ACCOUNTING PRONOUNCEMENTS

Effective with the beginning of year 1998, the company adopted AICPA Statement of Position 98-5, *Reporting on the Costs of Start-Up Activities*, which requires that cost of start-up and training activities be expensed as incurred. Previously, the company had capitalized these costs and amortized them over a five-year period. The cumulative effect of adopting this change was to reduce first quarter 1998 income by $3.2 million, net of tax benefit of $2.1 million. If start-up costs had been expensed in prior years, net income would not have been materially different.

Also during 1998, the company adopted Statements of Financial Accounting Standards No. 130, *Reporting Comprehensive Income*; No. 131, *Disclosures About Segments*; and No. 132, *Disclosures About Pensions and Other Postretirement Benefits*. Adoption of these standards did not materially affect the company's financial statements as these standards dealt primarily with disclosure and presentation of financial information.

During 1999, the company will adopt AICPA Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use,* which requires the capitalization of qualifying internal and external costs incurred during the application development stage. All costs incurred during the preliminary project stage and post-implementation stage are to be expensed as incurred. The company does not believe that adoption of this statement will have a material effect on its earnings or financial position.

The company plans to adopt Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities,* effective beginning of 2000. This statement will require derivative positions to be recognized in the balance sheet at fair value. The company presently utilizes derivatives to manage interest rate risk and risk in its mortgage loan production operations. The company has not yet determined the effect upon adoption of this statement on earnings or financial position.

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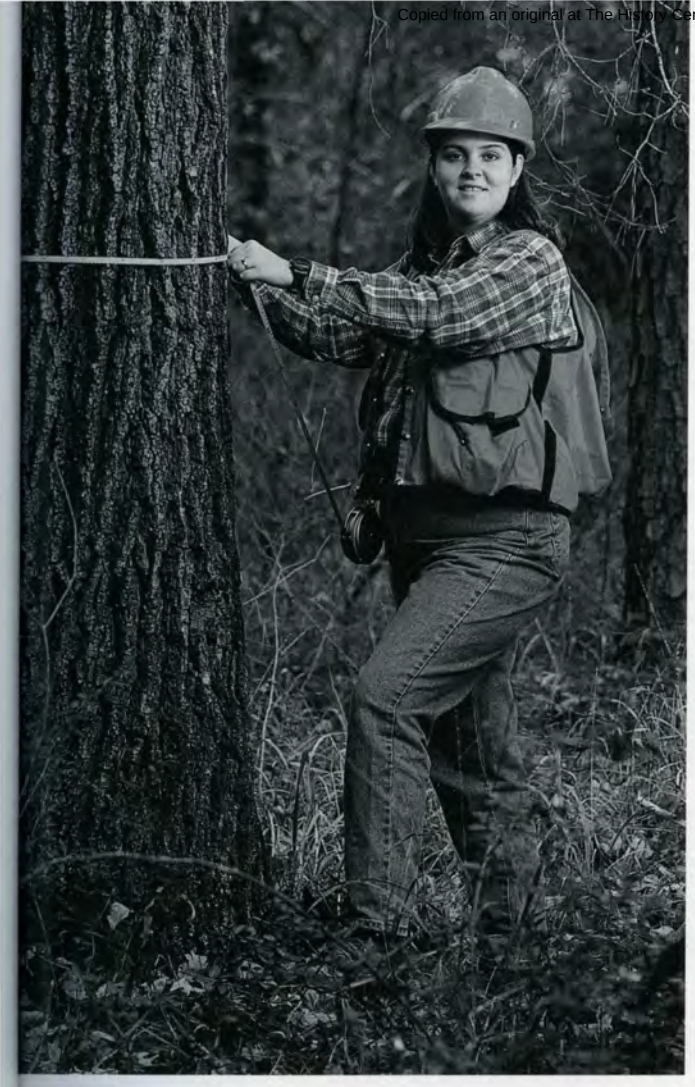

QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Interest Rate Risk

The company is subject to interest rate risk from the utilization of financial instruments such as adjustable-rate debt and other borrowings, as well as the lending and deposit-gathering activities of the Financial Services Group. The following table illustrates the estimated impact on pretax income of immediate, parallel and sustained shifts in interest rates for the subsequent 12-month period at year end 1998, with comparative information at year end 1997:

Change in Interest Rates	Increase (Decrease) in Income before Taxes *(in millions)*	
	1998	1997
+2%	**$ (26)**	$ 4
+1%	**$ (1)**	$ 9
0%	**$ —**	$ —
-1%	**$ 10**	$ (12)
-2%	**$ 29**	$ (14)

The change in exposure to interest rate risk from year end 1997 is due primarily to the Financial Services Group entering into interest rate floor and collar agreements to hedge the prepayment risk inherent in a portion of its adjustable-rate mortgage assets and an increase in the company's adjustable-rate debt. At year end 1997, the sensitivity of the Financial Services Group's earnings to changes in interest rates was inverse to the impact of interest rate changes on the company's adjustable-rate debt. By substantially decreasing the earnings volatility of the Financial Services Group to interest rate changes through the use of floor and collar agreements, the company's sensitivity to interest rate risk at the end of 1998 is primarily driven by changes in rates on the company's adjustable-rate debt.

Additionally, the fair value (estimated at $244 million at year end 1998) of the Financial Services Group's mortgage servicing rights is also affected by changes in interest rates. The fair value of the servicing rights has declined by $26 million (10 percent) since year end 1997, due to the recent decline in interest rates, actual and estimated future prepayments, and the smaller size of the servicing portfolio. The company estimates that a 1 percent decline in interest rates from current levels would decrease the fair value of the mortgage servicing rights by an additional $41 million.

Foreign Currency Risk

The company's exposure to foreign currency fluctuations on its financial instruments is not material because most of these instruments are denominated in U.S. dollars.

Commodity Price Risk

The company has no financial instruments subject to commodity price risks.

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Selected Financial Data

For the year	1998	1997*	1996	1995	1994	1993	1992	1991	1990	1989
(dollars in millions, except per share data)										
Total revenues	**$ 3,740**	$ 3,625	$ 3,460	$ 3,495	$ 2,967	$ 2,762	$ 2,734	$ 2,507	$ 2,401[c]	$ 1,943
Manufacturing net sales	**2,631**	2,680	2,645	2,731	2,335	2,127	2,096	1,898	1,892	1,894
Net income	**64[a]**	51	133	281	131	117[b]	147	138	232[c]	207
Capital expenditures:										
Manufacturing	**175**	233	275	386	463	340	359	378	324	260
Financial services	**39**	18	15	34	20	14	11	9	4	9
Depreciation and depletion:										
Manufacturing	**261**	255	244	208	200	191	167	158	140	126
Financial services	**14**	13	12	8	8	6	5	4	5	2
Earnings per share:										
Basic	**1.16[a]**	0.91	2.39	5.02	2.35	2.12[b]	2.66	2.53	4.24[c]	3.78
Diluted	**1.15[a]**	0.90	2.39	5.01	2.35	2.11[b]	2.65	2.51	4.20[c]	3.75
Dividends per common share	**1.28**	1.28	1.24	1.14	1.02	1.00	0.96	0.88	0.80	0.58
Weighted average shares outstanding:										
Basic	**55.8**	56.0	55.5	56.0	55.8	55.3	55.1	54.8	54.9	54.9
Diluted	**55.9**	56.2	55.6	56.1	55.9	55.5	55.5	55.2	55.4	55.3
Common shares outstanding at year end	**55.6**	56.3	55.4	55.7	56.0	55.5	55.2	54.9	54.6	54.9
At year end										
Total assets	**$15,990**	$14,364	$12,947	$12,764	$12,251	$11,959	$10,766	$10,068	$ 7,834[d]	$ 2,380
Long-term debt:										
Parent Company	**1,583**	1,438	1,522	1,489	1,316	1,045	964	864	501	399
Financial services	**210**	167	133	113	82	76	99	76	94	30
Preferred stock issued by subsidiary	**225**	150	—	—	—	—	—	—	—	—
Ratio of total debt to total capitalization - Parent Company	**44%**	41%	43%	43%	43%	38%	38%	36%	26%	24%
Shareholders' equity	**1,998**	2,045	2,015	1,975	1,783	1,700	1,633	1,532	1,439	1,259

*Includes effects of acquiring Stockton Savings Bank and Knutson Mortgage Company.
[a]Includes a special after-tax charge of $28.9 million, or $0.52 per share, and a $3.2 million after-tax charge, or $0.06 per share, from cumulative effect of accounting change.
[b]Includes a credit of $50 million, or $0.90 per share, from cumulative effect of accounting changes.
[c]Includes operating results from consolidation of Guaranty Federal Bank, F.S.B., beginning January 1, 1990.
[d]Includes Savings Bank assets from consolidation of Guaranty Federal Bank, F.S.B., beginning January 1, 1990.

Common Stock Prices and Dividend Information

	1998			1997		
	Price Range			Price Range		
	High	Low	Dividends	High	Low	Dividends
1st Quarter	**$64-15/16**	**$ 50**	**$0.32**	$ 57	$ 52	$ 0.32
2nd Quarter	**67-1/4**	**52-1/8**	**0.32**	62-1/8	49-5/8	0.32
3rd Quarter	**55-15/16**	**42-11/16**	**0.32**	69-7/16	56-1/8	0.32
4th Quarter	**59-5/8**	**45-1/16**	**0.32**	65-7/8	49-11/16	0.32
For the year	**$ 67-1/4**	**$42-11/16**	**$1.28**	**$ 69-7/16**	**$ 49-5/8**	**$ 1.28**

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Summarized Statements of Income

Parent Company (Temple-Inland Inc.)

For the year *(in millions)*	**1998**	1997	1996
REVENUES			
Net sales	**$ 2,631**	$ 2,680	$ 2,645
Financial services earnings	**154**	132	63
	2,785	2,812	2,708
COSTS AND EXPENSES			
Cost of sales	**2,236**	2,348	2,198
Selling and administrative	**278**	265	249
Special charge	**47**	—	—
	2,561	2,613	2,447
OPERATING INCOME	**224**	199	261
Interest expense - net	**(106)**	(110)	(110)
Other	**6**	6	5
INCOME BEFORE TAXES	**124**	95	156
Taxes on income	**57**	44	23
INCOME BEFORE ACCOUNTING CHANGE	**67**	51	133
Cumulative effect of accounting change, net of tax	**(3)**	—	—
NET INCOME	**$ 64**	$ 51	$ 133

See the notes to the Parent Company summarized financial statements.

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Summarized Balance Sheets
Parent Company (Temple-Inland Inc.)

At year end *(in millions)*	**1998**	1997
ASSETS		
CURRENT ASSETS		
Cash	**$ 15**	$ 13
Receivables, less allowances of $13 in 1998 and $9 in 1997	**297**	281
Inventories:		
Work in process and finished goods	**93**	109
Raw materials	**242**	230
	335	339
Prepaid expenses	**14**	15
Total current assets	**661**	648
INVESTMENT IN TEMPLE-INLAND FINANCIAL SERVICES	**708**	576
PROPERTY AND EQUIPMENT		
Buildings	**574**	554
Machinery and equipment	**3,829**	3,689
Construction in progress	**104**	115
Less allowances for depreciation	**(2,242)**	(2,086)
	2,265	2,272
Timber and timberlands - less depletion	**499**	507
Land	**35**	34
Total property and equipment	**2,799**	2,813
OTHER ASSETS	**174**	163
TOTAL ASSETS	**$ 4,342**	$ 4,200
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	**$ 138**	$ 135
Accrued expenses	**171**	150
Employee compensation and benefits	**28**	23
Current portion of long-term debt	**2**	3
Total current liabilities	**339**	311
LONG-TERM DEBT	**1,583**	1,438
DEFERRED INCOME TAXES	**266**	252
POSTRETIREMENT BENEFITS	**145**	140
OTHER LIABILITIES	**11**	14
SHAREHOLDERS' EQUITY	**1,998**	2,045
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**$ 4,342**	$ 4,200

See the notes to the Parent Company summarized financial statements.

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Summarized Statements of Cash Flows

Parent Company (Temple-Inland Inc.)

For the year *(in millions)*	**1998**	1997	1996
CASH PROVIDED BY (USED FOR) OPERATIONS			
Net income	**$ 64**	$ 51	$ 133
Adjustments to reconcile net income to net cash:			
Cumulative effect of accounting change, net of tax	**3**	—	—
Special charge	**47**	—	—
Depreciation and depletion	**261**	255	244
Deferred taxes	**17**	18	(29)
Unremitted earnings from financial services	**(127)**	(111)	(39)
Receivables	**(12)**	7	(11)
Inventories	**9**	(30)	23
Accounts payable and accrued expenses	**(11)**	(7)	(27)
Other	**13**	(12)	19
	264	171	313
CASH PROVIDED BY (USED FOR) INVESTMENTS			
Capital expenditures for property and equipment	**(175)**	(233)	(275)
Proceeds from sale of property and equipment	**6**	52	5
Acquisitions and joint ventures, net	**(121)**	(9)	(27)
Acquisition of California Financial Holding Company, net of cash acquired	**—**	(22)	—
Capital contributions to financial services	**(44)**	(25)	—
Dividends from financial services	**44**	275	50
	(290)	38	(247)
CASH PROVIDED BY (USED FOR) FINANCING			
Additions to debt	**319**	36	213
Payments of debt	**(175)**	(125)	(198)
Purchase of stock for treasury	**(48)**	(59)	(16)
Cash dividends paid to shareholders	**(71)**	(71)	(69)
Other	**3**	9	3
	28	(210)	(67)
Net increase (decrease) in cash	**2**	(1)	(1)
Cash at beginning of year	**13**	14	15
Cash at end of year	**$ 15**	$ 13	$ 14

See the notes to the Parent Company summarized financial statements.

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Notes to the Parent Company (Temple-Inland Inc.) Summarized Financial Statements

NOTE A - Summary of Significant Accounting Policies

BASIS OF PRESENTATION

The summarized financial statements include the accounts of the Parent Company (Temple-Inland Inc.) and its manufacturing subsidiaries. Temple-Inland Financial Services, including the savings bank, mortgage banking and real estate development operations, is reflected in the summarized financial statements on the equity basis, except that related earnings are presented before tax to be consistent with the consolidated financial statements. All material intercompany amounts and transactions have been eliminated. These financial statements should be read in conjunction with Temple-Inland Inc. consolidated financial statements and Temple-Inland Financial Services summarized financial statements.

INVENTORIES

Inventories are stated at the lower of cost or market.

Cost of inventories amounting to $109.5 million at year end 1998 and $118.5 million at year end 1997 was determined by the last-in, first-out method (LIFO). The cost of the remaining inventories was determined principally by the average cost method, which approximates the first-in, first-out method (FIFO).

If the FIFO method of accounting had been applied to those inventories that were costed on the LIFO method, inventories would have been $6.9 million and $19.3 million higher than reported at year end 1998 and 1997, respectively.

PROPERTY AND EQUIPMENT

Property and equipment are stated at cost less allowances for accumulated depreciation and depletion. Depreciation is provided on the straight-line method based on estimated useful lives as follows:

CLASSIFICATION	ESTIMATED USEFUL LIVES
Buildings	15 to 40 years
Machinery and equipment:	
Manufacturing and production equipment	3 to 25 years
Transportation equipment	3 to 10 years
Office and other equipment	2 to 10 years

Certain machinery and production equipment is depreciated based on operating hours or units of production because depreciation occurs primarily through use rather than through elapsed time.

Timberlands are stated at cost, less accumulated cost of timber harvested. The portion of the cost of timberlands attributed to standing timber is charged against income as timber is harvested at rates determined annually, based on the relationship of unamortized timber costs to the estimated volume of recoverable timber. The costs of seedlings and reforestation of timberlands are capitalized.

The cost of additions and betterments is capitalized and the cost of maintenance and repairs is expensed.

START-UP COSTS

Effective with the beginning of the year 1998, start-up costs, including training activities, are expensed as incurred instead of being deferred and amortized over a five-year period. The cumulative effect of applying this change was $3.2 million, net of tax benefit of $2.1 million, and was recognized as of the beginning of the year 1998. Had start-up costs been expensed in prior years, net income would not have been materially different.

ENVIRONMENTAL LIABILITIES

Environmental expenditures resulting in additions to property and equipment are capitalized, while other environmental expenditures are expensed. Environmental remediation liabilities are recorded on an undiscounted basis when environmental assessments or cleanups are probable, and the costs can be reasonably estimated and are adjusted as further information develops or circumstances change. The estimated costs to close and remediate company-operated landfills are accrued over the estimated useful life of the landfill.

REVENUE RECOGNITION

Revenue is recognized upon passage of title to the customer, which is generally at the time of shipment.

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NOTE B - Long-Term Debt

Long-term debt consists of the following:

At year end (in millions)	1998	1997
Commercial Paper, other short-term borrowings, and borrowings under bank credit agreements — Average interest rate was 5.77% in 1998 and 5.66% in 1997	**$ 264.2**	$ 13.5
8.85% to 9.0% Notes Payable due 1998	**—**	90.0
9.0% Notes Payable due 2001	**200.0**	200.0
8.125% to 8.38% Notes Payable due 2006	**100.0**	100.0
7.25% Notes Payable due 2004	**100.0**	100.0
8.25% Debentures due 2022	**150.0**	150.0
Private placement debt — 6.59% to 7.31% Notes due 1998 through 2007	**258.0**	338.0
Term Note due 2002 — Average interest rate was 5.81% in 1998 and 5.86% in 1997	**200.0**	200.0
Revenue Bonds due 2007 through 2028 — Average interest rate was 3.89% in 1998 and 3.94% in 1997	**201.1**	191.1
Other indebtedness due through 2006 — Average interest rate was 6.30% in 1998 and 6.37% in 1997	**111.3**	58.0
	1,584.6	1,440.6
LESS:		
Current portion of long-term debt	**(1.7)**	(2.5)
	$1,582.9	$1,438.1

At year end 1998, the Parent Company had bank credit agreements totaling $580 million, with final maturities at various dates in 2000 and 2001, that support commercial paper and other short-term borrowings. In June 1998, the company filed a shelf registration statement registering the sale of up to $500 million in debt securities and issued approximately $300 million in the first quarter of 1999. Commercial paper, other short-term borrowings and borrowings under bank credit agreements totaling $264.2 million, and current maturities of medium-term notes totaling $70.0 million, are classified as long-term debt in accordance with the company's intent and ability to refinance such obligations on a long-term basis.

Maturities of the Parent Company's long-term debt during the next five years are as follows (in millions): 1999 – $65; 2000 – $90; 2001 – $466; 2002 – $256; and 2003 – $65.
For an analysis of net interest expense, see page 33.



NOTE C - Special Charge

During the fourth quarter of 1998, the Parent Company recorded a special charge of $47.4 million, which included $13.0 million related to work force reductions in the Paper Group; $24.5 million related to asset impairments, principally related to the Paper Group's South American operations; and $9.9 million of asset impairments related to the Building Products Group. This charge was a result of the Paper Group's reorganization of its plant and mill operations and an assessment of its South American operations, due in part to the recent economic turmoil in that region, and the Building Products Group's sawmill conversion and modernization program.

The work force reductions affected approximately 250 employees, half of which accepted an early retirement incentive offer in December 1998. The terminated employees worked in the Paper Group's corrugated packaging operations. The special charge includes termination benefits associated with the early retirement offer and severance amounts for the involuntary terminations, most of which are expected to be paid during the first quarter of 1999.

The asset impairments represent the difference between the estimated discounted future cash flows and the asset carrying amounts. Of the total asset impairment, $7.9 million is for abandoned manufacturing assets, $6.5 million is for plant and equipment that will continue to be used, and $20.0 million is for the South American operations.

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Summarized Statements of Income
Financial Services Group

For the year *(in millions)*	**1998**	1997	1996
INTEREST INCOME			
Loans receivable and mortgage loans held for sale	**$ 584**	$ 526	$ 426
Mortgage-backed and investment securities	**150**	161	184
Other earning assets, including covered assets in 1996	**4**	22	21
Total interest income	**738**	709	631
INTEREST EXPENSE			
Deposits	**357**	331	308
Borrowed funds	**137**	157	127
Total interest expense	**494**	488	435
NET INTEREST INCOME	**244**	221	196
Provision for loan losses	**1**	(2)	14
NET INTEREST INCOME AFTER PROVISION FOR LOAN LOSSES	**243**	223	182
NONINTEREST INCOME			
Loan origination, marketing and servicing fees	**208**	127	87
Other	**163**	109	97
Total noninterest income	**371**	236	184
NONINTEREST EXPENSE			
Compensation and benefits	**174**	134	105
Other	**272**	186	154
SAIF assessment expense	**—**	—	44
Total noninterest expense	**446**	320	303
INCOME BEFORE TAXES AND MINORITY INTEREST	**168**	139	63
Minority interest in income of consolidated subsidiary	**(14)**	(7)	—
INCOME BEFORE TAXES	**154**	132	63
Taxes on income	**27**	21	24
NET INCOME	**$ 127**	$ 111	$ 39

See the notes to Financial Services Group summarized financial statements.

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Summarized Balance Sheets

Financial Services Group

At year end *(in millions)*	**1998**	1997
ASSETS		
Cash and cash equivalents	**$ 229**	$ 175
Mortgage loans held for sale	**621**	439
Loans receivable	**8,101**	6,451
Mortgage-backed and investment securities	**2,485**	2,806
Other assets	**964**	914
TOTAL ASSETS	**$12,400**	$ 10,785
LIABILITIES		
Deposits	**$ 7,338**	$ 7,375
Securities sold under repurchase agreements	**—**	270
Federal Home Loan Bank advances	**3,221**	1,685
Other borrowings	**210**	167
Other liabilities	**698**	562
Preferred stock issued by subsidiary	**225**	150
TOTAL LIABILITIES	**11,692**	10,209
SHAREHOLDERS' EQUITY	**708**	576
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	**$12,400**	$ 10,785

See the notes to Financial Services Group summarized financial statements.

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Summarized Statements of Cash Flows
Financial Services Group

For the year *(in millions)*	**1998**	1997	1996
CASH PROVIDED BY (USED FOR) OPERATIONS			
Net income	**$ 127**	$ 111	$ 39
Adjustments to reconcile net income to net cash:			
Provision for amortization, depreciation and accretion	**108**	43	33
Gain on sales of securities available-for-sale	**—**	3	—
Mortgage loans held for sale	**(183)**	(99)	(88)
Collections and remittances on loans serviced for others, net	**129**	193	(7)
Other	**(99)**	(70)	(65)
	82	181	(88)
CASH PROVIDED BY (USED FOR) INVESTMENTS			
Purchases of securities available-for-sale	**(208)**	(121)	(4)
Maturities of securities available-for-sale	**300**	210	98
Maturities and redemptions of securities held-to-maturity	**349**	308	322
Loans originated or acquired, net of principal collected on loans	**(1,852)**	(1,084)	(672)
Proceeds from sale of securities available-for-sale	**53**	844	206
Acquisitions	**—**	(13)	(11)
Capital expenditures for property and equipment	**(39)**	(18)	(15)
Other	**28**	28	2
	(1,369)	154	(74)
CASH PROVIDED BY (USED FOR) FINANCING			
Net increase (decrease) in deposits	**(36)**	128	(112)
Securities sold under repurchase agreements and short-term borrowings, net	**788**	(609)	285
Additions to debt	**770**	411	68
Payments of debt	**(251)**	(204)	(151)
Capital contributions from Parent Company	**44**	25	—
Proceeds from sale of subsidiary preferred stock	**75**	150	—
Dividends paid to Parent Company	**(44)**	(275)	(50)
Other	**(5)**	—	(7)
	1,341	(374)	33
Net increase (decrease) in cash and cash equivalents	**54**	(39)	(129)
Cash and cash equivalents at beginning of year	**175**	214	343
Cash and cash equivalents at end of year	**$ 229**	$ 175	$ 214

See the notes to Financial Services Group summarized financial statements.

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Notes to Financial Services Group Summarized Financial Statements

NOTE A - Summary of Significant Accounting Policies

BASIS OF PRESENTATION

Temple-Inland Financial Services Group (group) summarized financial statements include savings bank, mortgage banking, real estate development activities and insurance operations. All material intercompany amounts and transactions have been eliminated. Certain amounts have been reclassified to conform with current year's classification. These financial statements should be read in conjunction with Temple-Inland Inc.'s consolidated financial statements.

MORTGAGE LOANS HELD FOR SALE

Mortgage loans originated and held for sale are carried at the lower of cost or estimated market in the aggregate. Net unrealized losses are recognized in a valuation allowance by charges to income.

LOANS RECEIVABLE AND ALLOWANCE FOR LOAN LOSSES

Loans receivable are stated at unpaid net principal balances, less the allowance for loan losses and net deferred loan origination fees and costs. The allowance for loan losses is increased by charges to income and by the portion of the purchase price related to credit risk on bulk purchases of loans, and decreased by charge-offs, net of recoveries. Management's periodic evaluation of the adequacy of the allowance is based on the group's past loan loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, estimated value of any underlying collateral, and current economic conditions.

Loans receivable are assigned a risk rating to distinguish levels of credit risk and identify higher or unacceptable credit risks and deteriorating loan quality. These risk ratings are categorized as pass or criticized grade, with the resultant allowance for loan losses based on this distinction. Certain loan portfolios are considered to be performance based and are graded by analyzing performance through assessment of delinquency status. The allowance for loan losses is comprised of an allowance based on criticized graded loans, an allowance based on pass graded loans and an unallocated allowance based on analysis of other environmental factors.

Allowances established on the net outstanding principal balance of criticized graded loans range from 5 percent to 35 percent on Substandard classified loans, 36 percent to 70 percent on Doubtful classified loans, and 100 percent on Loss classified loans, respectively. The group uses general allowances for pools of loans with relatively similar risks based on management's assessment of homogeneous attributes, such as product types, markets, aging and collateral.

The group uses information on historic trends in delinquencies, charge-offs and recoveries to identify unfavorable trends. The analysis considers adverse trends in the migration of classifications to be an early warning of potential problems that would indicate a need to increase loss provisions over historic levels. The group also establishes a level of unallocated allowance to support the portfolio as a whole based on adverse conditions considered probable of resulting in losses in the loan portfolios, including certain segments or as a whole. For this portion of the allowance, group management considers the level, severity and trend of classified assets; level and trend of delinquent and non-accrual loans; recent loss experience trends; concentrations of credit; size of individual credit exposure; current economic conditions; and trends in portfolio volume, maturity and composition.

Interest on loans receivable is credited to income as earned. The accrual of interest ceases when collection becomes doubtful. When interest accrual ceases, uncollected interest previously credited to income is reversed. Certain loan fees and direct loan origination costs are deferred. These net fees or costs, as well as premiums and discounts on loans, are amortized to income using the interest method over the remaining period to contractual maturity, adjusted for anticipated prepayments. Any unamortized loan fees or costs, premiums, or discounts are taken to income in the event a loan is sold or repaid.

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MORTGAGE-BACKED AND INVESTMENT SECURITIES

The group determines the appropriate classification of mortgage-backed and investment securities at the time of purchase and confirms the designation of these debt securities as of each balance sheet date. Debt securities are classified as held-to-maturity and stated at amortized cost when the group has both the intent and ability to hold the securities to maturity. Otherwise, debt securities and marketable equity securities are classified as available-for-sale and are stated at fair value with any unrealized gains and losses, net of tax, reported as a component of shareholders' equity.

The cost of securities classified as held-to-maturity or available-for-sale is adjusted for amortization of premiums and accretion of discounts by a method that approximates the interest method over the estimated lives of the securities. Should such assets be sold, gains and losses are recognized based on the specific-identification method.

DERIVATIVE FINANCIAL INSTRUMENTS

The operations of Guaranty Federal Bank (Guaranty) are subject to the risk of interest rate fluctuations to the extent that interest-earning assets and interest-bearing liabilities mature or reprice at different times or in differing amounts. Guaranty is also subject to prepayment risk inherent on a portion of its adjustable-rate mortgage assets. To maintain acceptable levels of interest rate and liquidity risk, Guaranty enters into various types of interest rate contracts for purposes other than trading.

The net amount payable or receivable on interest rate contracts is recorded as an adjustment to interest income or expense (the accrual accounting method). Premiums paid for interest rate contracts, net of premiums received for those sold, are included in the carrying value of the related interest-earning assets or interest-bearing liabilities, and amortized as an adjustment to the yield of the designated assets or liabilities over the contract periods. These interest rate contracts had no significant impact on the group's effective interest yield for the years 1998, 1997 and 1996.

The company plans to adopt Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, effective beginning of 2000. This statement will require derivative positions to be recognized in the balance sheet at fair value. The company presently utilizes derivatives to manage interest rate risk and risk in its mortgage loan production operations. The company has not determined the effect of this statement on earnings or financial position upon adoption.

REAL ESTATE

Real estate consists primarily of land and commercial properties held for development and sale, although the operation also holds certain properties for the production of income. Interest on indebtedness and property taxes during the development period, as well as improvements and other development costs, are generally capitalized. The cost of land sales is determined using the relative sales value method. Real estate also includes properties acquired through loan foreclosure by Guaranty and Temple-Inland Mortgage Corporation (TIMC).

Real estate held for future development and real estate projects that are being developed are evaluated for impairment in accordance with the recognition and measurement provisions governing long-lived assets to be held and used in operations. Real estate projects that are substantially completed and ready for their intended use are measured at the lower of carrying amount or estimated fair value less cost to sell in accordance with the provisions governing long-lived assets that are to be disposed of.

MORTGAGE LOAN SERVICING RIGHTS

The group allocates a portion of the cost of originating a mortgage loan to the mortgage servicing right based on its fair value relative to the loan as a whole. Capitalized mortgage loan servicing rights are amortized in proportion to, and over the period of, estimated net servicing revenues.

The fair market value of originated mortgage servicing rights is estimated using buyers' quoted prices for servicing rights with similar attributes, such as loan type, principal balance, escrow and geographic location. Purchased mortgage servicing rights are recorded at cost.

To evaluate possible impairment of mortgage servicing rights, the portfolio is periodically stratified based on predominant risk characteristics and the capitalized basis of each stratum is compared to fair value. Predominant risk characteristics considered include loan type and interest rate. Should the capitalized mortgage servicing rights, net of amortization, exceed fair value, impairment is recognized through a valuation allowance.

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FEDERAL INCOME TAXES

The group is included in the consolidated income tax return filed by the company. Under an agreement with the company, the group provides a current income tax provision that takes into account the separate taxable income of the group. Deferred income taxes are recorded by the group.

NOTE B - Acquisitions

On November 14, 1998, the company signed a definitive merger agreement to acquire all of the outstanding stock of HF Bancorp, Inc. for $18.50 per share. Total assets, the majority of which are held by its subsidiary, Hemet Federal Savings & Loan Association (Hemet), are approximately $1 billion and consist primarily of residential, consumer and construction loans, mortgage-backed securities and short-term investments. Total liabilities approximate $0.9 billion and consist primarily of deposits. Hemet operates 18 branches in California. The purchase price of $118 million will consist of either all cash or a combination of company common stock and cash, and will be accounted for as a purchase business combination. The transaction, subject to the approval of regulatory authorities and HF Bancorp, Inc. shareholders, is anticipated to close during the second quarter of 1999.

On June 27, 1997, the company acquired all of the outstanding stock of California Financial Holding Company, the parent company of Stockton Savings Bank, F.S.B. (SSB), and merged the operations of SSB into Guaranty. Total assets and liabilities of SSB at acquisition were approximately $1.4 billion (primarily loans and securities) and $1.3 billion (primarily deposits and FHLB advances), respectively. At closing, the company issued approximately 1,614,000 shares of common stock valued at $96.1 million and paid approximately $47.3 million in cash. The excess of purchase price over the fair market value of net assets acquired of approximately $63 million is being amortized on the straight-line method over 25 years.

Effective May 31, 1997, TIMC acquired 100 percent of the common stock of Knutson Mortgage Corporation, a corporation engaged in mortgage banking activities, for a purchase price of approximately $14.6 million. Effective February 1, 1996, TIMC acquired all of the stock of Western Cities Mortgage Corporation, a California-based mortgage banking entity, for a purchase price of $11.5 million. These transactions in 1997 and 1996 increased the production branch network by a total of 50 branches and the principal balance of the loan servicing portfolio by approximately $6.4 billion and $875 million, respectively.

The consummated acquisitions were accounted for under the purchase method of accounting and, accordingly, the acquired assets and liabilities were adjusted to their estimated fair values at the date of the acquisitions. The operating results of the consummated acquisitions are included in the accompanying summarized financial statements from the acquisition dates. The unaudited pro forma results of operations, assuming the acquisitions had been effected as of the beginning of the applicable fiscal year, would not have been materially different from those reported.

NOTE C - Loans Receivable

Loans receivable consisted of the following:

At year end	**1998**	1997
(in millions)		
Real estate mortgage	**$ 4,632.9**	$ 4,525.0
Construction and development (including residential)	**4,702.6**	2,975.1
Commercial and business	**1,887.1**	1,142.1
Consumer and other	**877.3**	590.2
	12,099.9	9,232.4
LESS:		
Unfunded portion of loans	**3,927.7**	2,709.7
Unamortized purchase premiums and discounts	**(19.2)**	(21.3)
Net deferred fees	**3.9**	2.0
Allowance for loan losses	**86.6**	91.1
	3,999.0	2,781.5
	$ 8,100.9	$ 6,450.9

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Mortgages are primarily single-family adjustable-rate loans secured by properties located throughout the United States. Construction and development loans consist primarily of office, multi-family, retail, industrial and assisted living and are predominantly located in Texas, California, Florida, Georgia, Colorado, Illinois and Arizona. At year end 1998, the group had commitments to originate or purchase primarily variable-rate loans totaling approximately $2.0 billion. The amount to be ultimately funded is uncertain. See Note D below for information regarding mortgage loans securitized during 1998 and 1997.

Activity in the allowance for loan losses was as follows:

For the year *(in millions)*	**1998**	1997	1996
Balance, beginning of year	**$ 91.1**	$ 68.4	$ 65.5
Provision for loan losses	**0.6**	(1.7)	13.8
Additions related to acquisitions and bulk purchases of loans, net of adjustments	**0.1**	30.4*	(0.7)
Charge-offs, net of recoveries	**(5.2)**	(6.0)	(10.2)
Balance, end of year	**$ 86.6**	$ 91.1	$ 68.4

**Principally related to the acquisition of the loan portfolio of Stockton Savings Bank, F.S.B.*

NOTE D - Mortgage-Backed and Investment Securities

The amortized cost and fair values of mortgage-backed and investment securities consisted of the following:

At year end **1998** *(in millions)*	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
HELD-TO-MATURITY				
Mortgage-backed securities:				
FNMA certificates	**$ 781.7**	**$ —**	**$ (18.1)**	**$ 763.6**
FHLMC certificates	**157.7**	**—**	**(3.6)**	**154.1**
Collateralized mortgage obligations	**184.0**	**—**	**(6.4)**	**177.6**
Private issuer pass-through securities	**290.0**	**—**	**(8.3)**	**281.7**
	1,413.4	**—**	**(36.4)**	**1,377.0**
AVAILABLE-FOR-SALE				
Mortgage-backed securities:				
FNMA certificates	**752.1**	**6.6**	**(2.0)**	**756.7**
FHLMC certificates	**1.7**	**—**	**—**	**1.7**
GNMA certificates	**0.1**	**—**	**—**	**0.1**
Collateralized mortgage obligations	**120.1**	**0.2**	**(0.1)**	**120.2**
Private issuer pass-through securities	**14.9**	**—**	**(2.0)**	**12.9**
	888.9	**6.8**	**(4.1)**	**891.6**
Debt securities:				
Corporate securities	**2.8**	**—**	**—**	**2.8**
Equity securities, primarily Federal Home Loan Bank stock	**176.9**	**—**	**—**	**176.9**
	$1,068.6	**$ 6.8**	**$ (4.1)**	**$1,071.3**

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At year end 1997 *(in millions)*	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
HELD-TO-MATURITY				
Mortgage-backed securities:				
FNMA certificates	$ 924.8	$ 0.1	$ (27.3)	$ 897.6
FHLMC certificates	186.9	—	(5.7)	181.2
Collateralized mortgage obligations	253.1	—	(8.7)	244.4
Private issuer pass-through securities	403.5	—	(10.1)	393.4
	1,768.3	0.1	(51.8)	1,716.6
AVAILABLE-FOR-SALE				
Mortgage-backed securities:				
FNMA certificates	892.3	2.8	(5.7)	889.4
FHLMC certificates	2.3	—	—	2.3
GNMA certificates	0.1	—	—	0.1
Collateralized mortgage obligations	1.0	0.1	—	1.1
Private issuer pass-through securities	57.8	—	(2.6)	55.2
	953.5	2.9	(8.3)	948.1
Debt securities:				
Corporate securities	3.0	—	—	3.0
Equity securities, primarily Federal Home Loan Bank stock	85.8	0.4	—	86.2
	$ 1,042.3	$ 3.3	$ (8.3)	$ 1,037.3

The mortgage loans underlying mortgage-backed securities have adjustable interest rates and generally have contractual maturities ranging from 15 to 40 years, with principal and interest installments due monthly. The actual maturities of mortgage-backed securities may differ from the contractual maturities of the underlying loans because issuers or mortgagors may have the right to call or prepay their securities or loans.

Certain mortgage-backed and investment securities are guaranteed directly or indirectly by the U.S. government or its agencies. Other mortgage-backed securities, which are not guaranteed by the U.S. government or its agencies, are senior subordinated securities considered investment-grade quality by third-party rating agencies. The collateral underlying these securities is primarily residential properties located in California.

Guaranty securitized $164 million and $962 million of mortgage loans previously held in portfolio during 1998 and 1997, respectively. The transfer to mortgage-backed securities was recorded at the carrying value of the mortgage loans at the time of securitization. The group held $657 million and $768 million in such securities at year end 1998 and 1997, respectively.

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NOTE E - Deposits

Deposits consisted of the following:

At year end	**1998**		1997	
	Stated Rate	**Amount**	Stated Rate	Amount
(dollars in millions)				
Noninterest-bearing demand	**—**	**$ 152.1**	—	$ 160.0
Interest-bearing demand	**2.08%**	**1,135.0**	2.55%	1,107.7
Savings deposits	**2.21%**	**207.3**	2.27%	205.9
Time deposits	**5.39%**	**5,843.7**	5.63%	5,900.3
Deposit premium		**0.3**		0.9
		$7,338.4		$7,374.8

Scheduled maturities of time deposits at year end 1998 are as follows:

Time deposits	**$100,000 or more**	**Less than $100,000**	**Total**
(in millions)			
3 months or less	**$ 240.3**	**$1,353.5**	**$1,593.8**
Over 3 through 6 months	**192.3**	**1,125.2**	**1,317.5**
Over 6 through 12 months	**226.8**	**1,396.6**	**1,623.4**
Over 12 months	**178.9**	**1,130.1**	**1,309.0**
	$ 838.3	**$5,005.4**	**$5,843.7**

A summary of interest paid by the group is shown below:

For the year	**1998**	1997	1996
(in millions)			
Interest on deposits	**$ 356.9**	$ 333.4	$ 310.8
Interest on borrowed funds	**137.1**	160.5	128.7
	$ 494.0	$ 493.9	$ 439.5

At year end 1998, time deposits maturity dates were as follows (in millions): 1999 – $4,534.7; 2000 – $626.2; 2001 – $374.0; 2002 – $265.9; 2003 – $40.6; 2004 and thereafter – $2.3.

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NOTE F - Securities Sold under Repurchase Agreements

Securities sold under repurchase agreements were delivered to brokers/dealers who retained such securities as collateral for the borrowings and have agreed to resell the same securities back to Guaranty at the maturities of the agreements. The agreements generally mature within 30 days.

Information concerning borrowings under repurchase agreements is summarized as follows:

	1998	1997
(dollars in millions)		
At year end:		
Weighted average interest rate	**—**	5.90%
Mortgage-backed securities pledged to secure the agreements:		
Carrying value	**$ —**	$ 287.8
Estimated market value	**—**	281.3
For the year:		
Average daily balance	**349.2**	1,297.2
Maximum month-end balance	**1,254.9**	1,696.6

NOTE G - Federal Home Loan Bank Advances

Pursuant to collateral agreements with the Federal Home Loan Bank of Dallas (FHLB), advances are secured by a blanket floating lien on Guaranty's assets and by securities on deposits at the FHLB. The weighted average interest rate of the advances was 5.09 percent and 6.01 percent at year end 1998 and 1997, respectively. At year end 1998, the advances had calendar year maturity dates as follows (in millions): 1999 – $3,194.1; 2000 – $10.0; 2001 – $5.0; 2002 – $0; 2003 – $12.0; 2004 and thereafter – $0.

NOTE H - Other Borrowings

Other borrowings, which represent borrowings of non-savings bank entities, consisted of the following:

At year end	**1998**	1997
(in millions)		
Long-term debt with an average rate of 7.47% and 7.16% during 1998 and 1997, respectively, due through 2001	**$ 170.0**	$ 147.0
Long-term debt at various rates that approximate prime, secured primarily by real estate	**39.8**	20.5
	$ 209.8	$ 167.5

At year end 1998, a non-savings bank subsidiary had a $190 million credit facility that expires in 2001, with $20 million remaining unused.

Maturities of other borrowings are as follows (in millions): 1999 – $2.6; 2000 – $2.3; 2001 – $171.8; 2002 – $1.1; 2003 – $1.1; 2004 and thereafter – $30.9.

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NOTE I - Preferred Stock Issued by Subsidiary

In May 1997, Guaranty Preferred Capital Corporation (GPCC), a wholly owned subsidiary of Guaranty, issued 150,000 shares of noncumulative floating-rate preferred stock, with a liquidation preference of $1,000 per share. GPCC is a real estate investment trust (REIT) established for the purpose of acquiring, holding and managing real estate mortgage assets. Dividends on preferred stock are noncumulative and are payable when declared. If redeemed within a specified time after the tenth anniversary, the preferred stock may be redeemed for cash at the option of GPCC, in whole or in part, at a redemption price of $1,000 per share. The preferred stock is convertible to Guaranty preferred stock upon the occurrence of certain regulatory events. GPCC issued an additional $75 million of noncumulative floating-rate preferred stock on May 28, 1998.

NOTE J - Mortgage Loan Servicing

The group services mortgage loans that are owned primarily by independent investors. The group serviced approximately 256,300 and 351,600 mortgage loans aggregating $22.9 billion and $26.1 billion in outstanding principal balance as of year end 1998 and 1997, respectively.

This group is required to advance, from company funds, escrow and foreclosure costs on loans that it services. The majority of these advances are recoverable, except for certain amounts for loans serviced for GNMA, which are reserved. Market risk is assumed related to disposing of certain foreclosed VA loans. No significant losses were incurred during 1998, 1997 or 1996 in connection with this risk.

Capitalized mortgage loan servicing rights, net of accumulated amortization, were as follows:

During 1998, the group sold servicing rights on mortgage loans with approximately $4.5 billion in outstanding principal balance ($1.3 billion of which was not transferred until 1999), resulting in gains of $27.6 million. The estimated fair value of the capitalized mortgage servicing rights at year end 1998 was $217 million. Fair value was determined utilizing market-driven assumptions for prepayment speeds, discount rates and other variables.

NOTE K - Interest Rate Risk Management

In 1998, Guaranty entered into interest rate floor and collar agreements to minimize the effect a decline in interest rates might have on earnings due to acceleration of prepayments on Guaranty's mortgage assets. At year end 1998, Guaranty was a party to interest rate floors with a notional amount of $850 million and interest rate collars with a notional amount of $850 million.

The interest rate floor agreements will generate interest payments to Guaranty if the variable rate based on various Constant Maturity Swap (CMS) indices falls below the average strike rate of 5.25 percent. The interest rate collar agreements incorporate a floor from which Guaranty would receive payments if the CMS indices fall below the average strike rate of 5.02 percent and a cap that would require Guaranty to pay if the CMS indices exceed the average strike rate of 5.60 percent. The average of the CMS indices at year end 1998 was approximately 5.44 percent. These agreements mature in 1999.

Guaranty is also a party to various interest rate corridor agreements to reduce the impact of increases in interest rates on its investments in adjustable-rate mortgage-backed securities that have lifetime interest rate caps. Under these agreements with notional amounts totaling $319 million and

At year end **1998**	Purchased Loan Servicing Rights, Net	Originated Loan Servicing Rights, Net	Reserve For Impairment	Total
(in millions)				
Balance, beginning of year	**$ 159.0**	**$ 42.3**	$ —	**$ 201.3**
Additions	**46.5**	**71.7**	—	**118.2**
Scheduled amortization	**(40.2)**	**(15.8)**	—	**(56.0)**
Basis in servicing sold	**(23.6)**	**(8.8)**	—	**(32.4)**
	141.7	**89.4**	—	**231.1**
Reserve for impairment	**—**	**—**	**(16.8)**	**(16.8)**
Balance, end of year	**$ 141.7**	**$ 89.4**	$ **(16.8)**	**$ 214.3**
At year end 1997				
(in millions)				
Balance, beginning of year	$ 84.1	$ 24.7	—	$ 108.8
Additions	92.3[a]	22.8	—	115.1
Scheduled amortization	(17.0)	(5.2)	—	(22.2)
Basis in servicing sold	(0.4)	—	—	(0.4)
Balance, end of year	$ 159.0	$ 42.3	—	$ 201.3

[a]*Includes approximately $74 million relating to the acquisition of Knutson Mortgage Corporation.*

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$379 million at year end 1998 and 1997, respectively, Guaranty simultaneously purchased and sold caps whereby it receives interest if the variable rate based on the FHLB Eleventh District Cost of Funds (EDCOF) Index (4.69 percent at year end 1998) exceeds an average strike rate of 8.80 percent, and pays interest if the same variable rate exceeds a strike rate of 11.75 percent. These agreements mature through 2003.

Guaranty is also a party to an interest rate cap agreement to reduce the impact of interest rate increases on certain adjustable-rate investments with lifetime caps. Under this agreement, with a notional amount of $29 million, Guaranty would receive payments if the EDCOF exceeds the strike rate of 10 percent. The agreement matures in 2004.

The amounts potentially subject to credit risks are the streams of payments receivable by Guaranty under the terms of the contracts and not the notional amounts used to express the volumes of these transactions. Guaranty minimizes its exposure to such credit risk by entering into contracts with major U.S. securities firms.

NOTE L - Regulatory Capital Matters

Guaranty is subject to various regulatory capital requirements administered by the federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material effect on Guaranty's financial statements.

Under capital adequacy guidelines and the regulatory framework for prompt corrective action, Guaranty must meet specific capital guidelines that involve quantitative measures of Guaranty's assets, liabilities and certain off-balance-sheet items as calculated under regulatory accounting practices. Guaranty's capital amounts and classification are also subject to qualitative judgments by the regulators about components, risk weightings and other factors. The payment of dividends from Guaranty is subject to proper regulatory notification.

Quantitative measures established by regulation to ensure capital adequacy require Guaranty to maintain minimum amounts and ratios (set forth in the table below) of total and Tier I capital to risk-weighted assets, and of Tier I capital to adjusted tangible assets. Management believes, as of year end 1998, Guaranty met all its capital adequacy requirements.

As of year end 1998, the most recent notification from regulators categorized Guaranty as "well capitalized" under the regulatory framework for prompt corrective action. To be so categorized as "well capitalized," Guaranty must maintain minimum total risk-based, Tier I (Core) risk-based, and Tier I (Core) leverage capital ratios as set forth in the table. Because of loan growth experienced by Guaranty in 1998, changes in asset mix in Guaranty's balance sheet and prospective changes in Guaranty's risk-based capital calculation, Guaranty expects an increase in its capital requirements. As a result, the company expects to increase capital in Guaranty by up to $160 million in order to maintain its classification of "well capitalized."

Guaranty's actual capital amounts and ratios are also presented in the table below. No amounts were deducted from capital for interest rate risk at year end 1998 or 1997.

	Actual		*For Capital Adequacy Purposes*		*To Be Well Capitalized Under Prompt Corrective Action Provisions*	
(dollars in millions)	Amount	Ratio	Amount	Ratio	Amount	Ratio
At year end **1998**:						
Total Risk-Based Ratio						
(Risk-based capital/total risk-weight assets)	**$ 828.8**	**10.17%**	**≥$651.9**	**≥8.0%**	**≥$814.7**	**≥10.0%**
Tier I (Core) Risk-Based Ratio						
(Core capital/total risk-weight assets)	**$ 755.5**	**9.27%**	**≥$325.9**	**≥4.0%**	**≥$488.8**	**≥6.0%**
Tier I (Core) Leverage Ratio						
(Core capital/adjusted tangible assets)	**$ 755.5**	**6.31%**	**≥$479.2**	**≥4.0%**	**≥$599.0**	**≥5.0%**
Tangible Ratio						
(Tangible capital/tangible assets)	**$ 755.5**	**6.31%**	**≥$179.7**	**≥1.5%**	**N/A**	**N/A**
At year end 1997:						
Total Risk-Based Ratio						
(Risk-based capital/total risk-weight assets)	$ 651.0	10.14%	≥$ 513.7	≥8.0%	≥$ 641.9	≥10.0%
Tier I (Core) Risk-Based Ratio						
(Core capital/total risk-weight assets)	$ 570.7	8.89%	≥$ 256.8	≥4.0%	≥$ 385.2	≥6.0%
Tier I (Core) Leverage Ratio						
(Core capital/adjusted tangible assets)	$ 570.7	5.48%	≥$ 416.4	≥4.0%	≥$ 520.5	≥5.0%
Tangible Ratio						
(Tangible capital/tangible assets)	$ 570.7	5.48%	≥$ 156.2	≥1.5%	N/A	N/A

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Consolidated Statements of Income

Temple-Inland Inc. and Subsidiaries

For the year *(in millions, except per share data)*	**1998**	1997	1996
REVENUES			
Manufacturing	**$ 2,631**	$ 2,680	$ 2,645
Financial services	**1,109**	945	815
	3,740	3,625	3,460
COSTS AND EXPENSES			
Manufacturing	**2,514**	2,613	2,447
Special charge	**47**	—	—
Financial services	**955**	813	752
	3,516	3,426	3,199
OPERATING INCOME	**224**	199	261
Parent Company interest, net	**(106)**	(110)	(110)
Other	**6**	6	5
INCOME BEFORE TAXES	**124**	95	156
Taxes on income	**57**	44	23
INCOME BEFORE ACCOUNTING CHANGE	**67**	51	133
Cumulative effect of accounting change, net of tax	**(3)**	—	—
NET INCOME	**$ 64**	$ 51	$ 133
EARNINGS PER SHARE			
Basic:			
Income before accounting change	**$ 1.22**	$ 0.91	$ 2.39
Cumulative effect of accounting change, net of tax	**(.06)**	—	—
NET INCOME	**$ 1.16**	$ 0.91	$ 2.39
Diluted:			
Income before accounting change	**$ 1.21**	$ 0.90	$ 2.39
Cumulative effect of accounting change, net of tax	**(.06)**	—	—
NET INCOME	**$ 1.15**	$ 0.90	$ 2.39

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Consolidated Statements of Cash Flows

Temple-Inland Inc. and Subsidiaries

For the year *(in millions)*	**1998**	1997	1996
CASH PROVIDED BY (USED FOR) OPERATIONS			
Net income	**$ 64**	$ 51	$ 133
Adjustments to reconcile net income to net cash:			
Special charge	**47**	—	—
Cumulative effect of accounting change, net of tax	**3**	—	—
Depreciation and depletion	**275**	268	256
Amortization of goodwill	**7**	6	4
Deferred taxes	**18**	21	(11)
Amortization and accretion on financial instruments	**90**	26	20
Mortgage loans held for sale	**(183)**	(99)	(88)
Receivables	**(12)**	7	(11)
Inventories	**9**	(30)	23
Accounts payable and accrued expenses	**(11)**	(7)	(27)
Collections and remittances on loans serviced for others, net	**129**	193	(7)
Originated mortgage servicing rights	**(72)**	(23)	(18)
Other	**(18)**	(61)	(48)
	346	352	226
CASH PROVIDED BY (USED FOR) INVESTMENTS			
Capital expenditures for property and equipment	**(214)**	(251)	(290)
Proceeds from sale of property and equipment	**28**	53	7
Purchases of securities available-for-sale	**(208)**	(121)	(4)
Maturities of securities available-for-sale	**300**	210	98
Maturities and redemptions of securities held-to-maturity	**349**	308	322
Loans originated or acquired, net of principal collected on loans	**(1,852)**	(1,084)	(672)
Proceeds from sale of securities available-for-sale	**53**	844	206
Acquisitions and joint ventures, net	**(121)**	(22)	(38)
Acquisition of California Financial Holding Company, net of cash acquired	**—**	(22)	—
Other	**6**	27	(1)
	(1,659)	(58)	(372)
CASH PROVIDED BY (USED FOR) FINANCING			
Additions to debt	**1,089**	447	281
Payments of debt	**(426)**	(329)	(349)
Securities sold under repurchase agreements and short-term borrowings, net	**788**	(609)	285
Purchase of stock for treasury	**(48)**	(59)	(16)
Cash dividends paid to shareholders	**(71)**	(71)	(69)
Net increase (decrease) in deposits	**(36)**	128	(112)
Proceeds from sale of subsidiary preferred stock	**75**	150	—
Other	**(2)**	9	(4)
	1,369	(334)	16
Net increase (decrease) in cash and cash equivalents	**56**	(40)	(130)
Cash and cash equivalents at beginning of year	**188**	228	358
Cash and cash equivalents at end of year	**$ 244**	$ 188	$ 228

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Consolidating Balance Sheets

Temple-Inland Inc. and Subsidiaries

At year end **1998** *(in millions)*	Parent Company	Financial Services	Consolidated
ASSETS			
Cash and cash equivalents	$ 15	$ 229	$ 244
Mortgage loans held for sale	—	621	621
Loans receivable	—	8,101	8,101
Mortgage-backed and investment securities	—	2,485	2,485
Trade and other receivables	297	—	290
Inventories	335	—	335
Property and equipment	2,799	129	2,928
Other assets	188	835	986
Investment in Financial Services	708	—	—
TOTAL ASSETS	$ 4,342	$12,400	$15,990
LIABILITIES			
Deposits	$ —	$ 7,338	$ 7,338
Federal Home Loan Bank advances	—	3,221	3,221
Other liabilities	350	698	1,028
Long-term debt	1,583	210	1,793
Deferred income taxes	266	—	242
Postretirement benefits	145	—	145
Preferred stock issued by subsidiary	—	225	225
TOTAL LIABILITIES	$ 2,344	$11,692	$13,992
SHAREHOLDERS' EQUITY			
Preferred stock - par value $1 per share: authorized 25,000,000 shares; none issued			—
Common stock - par value $1 per share: authorized 200,000,000 shares; issued 61,389,552 shares including shares held in the treasury			61
Additional paid-in capital			357
Accumulated other comprehensive income (loss)			(17)
Retained earnings			1,810
			2,211
Cost of shares held in the treasury: 5,785,139 shares			(213)
TOTAL SHAREHOLDERS' EQUITY			1,998
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY			$15,990

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Consolidating Balance Sheets

Temple-Inland Inc. and Subsidiaries

At year end 1997 *(in millions)*	Parent Company	Financial Services	Consolidated
ASSETS			
Cash and cash equivalents	$ 13	$ 175	$ 188
Mortgage loans held for sale	—	439	439
Loans receivable	—	6,451	6,451
Mortgage-backed and investment securities	—	2,806	2,806
Trade and other receivables	281	—	277
Inventories	339	—	339
Property and equipment	2,813	103	2,916
Other assets	178	811	948
Investment in Financial Services	576	—	—
TOTAL ASSETS	$4,200	$10,785	$14,364
LIABILITIES			
Deposits	$ —	$ 7,375	$ 7,375
Securities sold under repurchase agreements and Federal Home Loan Bank advances	—	1,955	1,955
Other liabilities	325	562	871
Long-term debt	1,438	167	1,605
Deferred income taxes	252	—	223
Postretirement benefits	140	—	140
Preferred stock issued by subsidiary	—	150	150
TOTAL LIABILITIES	$2,155	$10,209	$ 12,319
SHAREHOLDERS' EQUITY			
Preferred stock - par value $1 per share: authorized 25,000,000 shares; none issued			—
Common stock - par value $1 per share: authorized 200,000,000 shares; issued 61,389,552 shares including shares held in the treasury			61
Additional paid-in capital			356
Accumulated other comprehensive income (loss)			(20)
Retained earnings			1,817
			2,214
Cost of shares held in the treasury: 5,069,011 shares			(169)
TOTAL SHAREHOLDERS' EQUITY			2,045
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY			$14,364

See the notes to the consolidated financial statements.

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Consolidated Statements of Shareholders' Equity

Temple-Inland Inc. and Subsidiaries

(in millions)	Common Stock	Paid-in Capital	Accumulated Other Comprehensive Income	Retained Earnings	Treasury Stock	Total
BALANCE AT YEAR END 1995	$ 61	$ 306	$ (14)	$ 1,773	$ (151)	$ 1,975
Comprehensive Income						
Net income	—	—	—	133	—	133
Other comprehensive income:						
Unrealized gains on securities	—	—	(9)	—	—	(9)
Foreign currency translation adjustments	—	—	(1)	—	—	(1)
Total comprehensive income	—	—	—	—	—	123
Dividends paid on common stock — $1.24 per share	—	—	—	(69)	—	(69)
Stock issued for stock plans — 149,232 shares	—	(1)	—	—	3	2
Stock reacquired for treasury — 358,623 shares	—	—	—	—	(16)	(16)
BALANCE AT YEAR END 1996	$ 61	$ 305	$ (24)	$ 1,837	$ (164)	$ 2,015
Comprehensive Income						
Net income	—	—	—	51	—	51
Other comprehensive income: Unrealized gains on securities of $3.0 million, net of reclassification adjustment for gains included in net income of $1.0 million	—	—	4	—	—	4
Total comprehensive income	—	—	—	—	—	55
Dividends paid on common stock — $1.28 per share	—	—	—	(71)	—	(71)
Stock issued for acquisition of California Financial Holding Company — 1,613,546 shares	—	48	—	—	48	96
Stock issued for stock plans — 253,075 shares	—	3	—	—	6	9
Stock reacquired for treasury — 994,830 shares	—	—	—	—	(59)	(59)
BALANCE AT YEAR END 1997	$ 61	$ 356	$ (20)	$ 1,817	$ (169)	$ 2,045
Comprehensive Income						
Net income	—	—	—	64	—	64
Other comprehensive income: Unrealized gains on securities of $6.0 million, net of reclassification adjustment for gains included in net income of $1.0 million	—	—	5	—	—	5
Minimum pension liability	—	—	(2)	—	—	(2)
Total comprehensive income	—	—	—	—	—	67
Dividends paid on common stock — $1.28 per share	—	—	—	(71)	—	(71)
Stock issued for stock plans — 134,430 shares	—	1	—	—	4	5
Stock reacquired for treasury — 850,558 shares	—	—	—	—	(48)	(48)
BALANCE AT YEAR END 1998	**$ 61**	**$ 357**	**$ (17)**	**$ 1,810**	**$ (213)**	**$ 1,998**

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Notes to the Consolidated Financial Statements

NOTE 1 - Summary of Significant Accounting Policies

BASIS OF PRESENTATION

The consolidated financial statements include the accounts of Temple-Inland Inc. and all subsidiaries in which the company has more than a 50 percent equity ownership. Investments in joint ventures and other subsidiaries in which the company has between a 20 percent and 50 percent equity ownership are reflected using the equity method. However, because certain assets and liabilities are in separate corporate entities, the consolidated assets are not available to satisfy all consolidated liabilities. All material intercompany amounts and transactions have been eliminated. Certain amounts have been reclassified to conform with current year's classification.

The preparation of the consolidated financial statements in accordance with generally accepted accounting principles requires management to make estimates and assumptions. These estimates and assumptions affect the amounts reported in the financial statements and accompanying notes, including disclosures related to contingencies. Actual results could differ from these estimates.

Included as an integral part of the consolidated financial statements are separate summarized financial statements and notes for the company's primary business groups, as well as the significant accounting policies unique to each group.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash on hand, amounts due from banks, commercial paper, agency discount notes, federal funds sold, and other short-term liquid instruments with original maturities of three months or less.

TRANSLATION OF INTERNATIONAL CURRENCIES

Balance sheets of the company's international operations where the functional currency is other than the U.S. dollar are translated into U.S. dollars at year end exchange rates. Adjustments resulting from financial statement translation are reported as a component of shareholders' equity. For other international operations where the functional currency is the U.S. dollar, inventories, property, plant and equipment are translated at the historical rate of exchange, while other assets and liabilities are translated at year end exchange rates. Translation adjustments for these operations are included in earnings and are not material.

Income and expense items are translated into U.S. dollars at average rates of exchange prevailing during the year. Gains and losses resulting from foreign currency transactions are included in earnings and are not material.

INCOME TAXES

Deferred income taxes are provided for temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes computed using current tax rates.

STOCK-BASED COMPENSATION

The company uses the intrinsic value method in accounting for its stock-based employee compensation plans.

LONG-LIVED ASSETS

Impairment losses are recognized when indicators of impairment are present and the estimated undiscounted cash flows are not sufficient to recover the assets carrying amount. Assets held for disposal are recorded at the lower of carrying value or estimated fair value, less costs to sell.

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NOTE 2 - Taxes on Income

Taxes on income from continuing operations consisted of the following:

For the year	**1998**	1997	1996
(in millions)			
CURRENT TAX PROVISION:			
U.S. Federal	**$ 30.8**	$ 21.9	$ 27.2
State and other	**7.6**	2.2	6.5
	38.4	24.1	33.7
DEFERRED TAX PROVISION:			
U.S. Federal	**15.5**	15.2	(16.5)
State and other	**0.8**	4.9	5.9
	16.3	20.1	(10.6)
PROVISION FOR INCOME TAXES	**$ 54.7**	$ 44.2	$ 23.1

Earnings or losses from continuing operations consisted of the following:

For the year	**1998**	1997	1996
(in millions)			
EARNINGS (LOSSES):			
U.S.	**$149.7**	$ 104.1	$ 163.6
Non-U.S.	**(30.6)**	(9.1)	(7.6)
	$119.1	$ 95.0	$ 156.0

The differences between the consolidated effective income tax rate and the federal statutory income tax rate include the following:

For the year	**1998**	1997	1996
(in millions)			
Taxes on income at statutory rate	**$ 41.7**	$ 33.3	$ 54.6
FDIC tax-sharing settlement	**—**	—	(31.5)
Book benefit of FDIC assistance and other permanent items	**1.2**	(0.8)	(11.6)
State and other taxes	**4.6**	5.1	8.1
Foreign losses not benefited	**5.7**	3.2	2.6
Goodwill	**1.5**	3.4	0.9
	$ 54.7	$ 44.2	$ 23.1

Significant components of the company's consolidated deferred tax assets and liabilities are as follows:

At year end	**1998**	1997
(in millions)		
DEFERRED TAX LIABILITIES:		
Depreciation	**$ 399.9**	$ 396.4
Timber and timberlands	**40.0**	41.9
Pensions	**28.4**	20.6
Other	**69.0**	63.3
Total deferred tax liabilities	**537.3**	522.2
DEFERRED TAX ASSETS:		
Alternative minimum tax credits	**292.9**	264.3
Net operating loss carryforwards	**31.6**	78.0
OPEB obligations	**55.7**	54.6
Other	**74.3**	54.9
Total deferred tax assets	**454.5**	451.8
VALUATION ALLOWANCE	**(158.9)**	(152.9)
Net deferred tax liability	**$ 241.7**	$ 223.3

The valuation allowance represents accruals for deductions that are uncertain and accordingly have not been recognized for financial reporting purposes. The change in the valuation allowance is primarily the result of increased foreign net operating losses, the future realization of which is not assured.

Income tax payments, net of refunds received, were $39 million, $21 million and $38 million during 1998, 1997 and 1996, respectively.

The company has domestic net operating loss carryforwards of $43 million that expire in 2009. In addition, the company has foreign net operating loss carryforwards of $35 million that expire from the year 2000 through the year 2008, and $13 million that may be carried forward indefinitely. Alternative minimum tax credits may be carried forward indefinitely.

As a result of the sale of Temple-Inland Food Service Corporation in 1997, the company realized a $2.3 million one-time increase in tax expense from non-deductible goodwill.

In connection with the acquisition of Guaranty in 1988, the company entered into an assistance agreement (Assistance Agreement) with the Federal Savings and Loan Insurance Corporation. Pursuant to the Assistance Agreement, the company received various tax benefits to be shared with the FDIC when the cash benefits were realized by the company. During the term of the Assistance Agreement, the company recorded these tax-sharing liabilities on an undiscounted basis. The company and the FDIC terminated the Assistance Agreement. As a part of this termination, the company and the FDIC agreed to a one-time payment that was based on the present value of the future liabilities. In 1996, the company recognized a credit to its tax provision of $31.5 million as a result of the completion of this transaction.

The Internal Revenue Service is examining the company's consolidated tax returns for the years 1987 through 1992. The resolution of these examinations is not expected to have a significant impact on the company's financial condition or results of operations.

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NOTE 3 - Fair Value of Financial Instruments

The carrying amount and fair value of financial instruments were as follows:

At year end *(in millions)*	**1998**		1997	
	Carrying Amount	**Fair Value**	Carrying Amount	Fair Value
FINANCIAL ASSETS:				
Loans receivable	**$8,100.9**	**$8,126.4**	$6,450.9	$6,454.9
Mortgage-backed and investment securities	**2,484.6**	**2,448.8**	2,805.7	2,754.0
FINANCIAL LIABILITIES:				
Deposits	**7,338.4**	**7,369.0**	7,374.8	7,380.2
FHLB advances	**3,220.9**	**3,223.1**	1,685.0	1,687.9
Total debt	**1,794.4**	**1,850.8**	1,608.1	1,675.8
OFF-BALANCE-SHEET INSTRUMENTS:				
Interest rate contracts	**—**	**(4.9)**	—	(2.3)
Commitments to extend credit	**—**	**(1.6)**	—	(0.7)

Differences between fair value and carrying amount are primarily due to instruments that provide fixed interest rates or contain fixed interest rate elements. Inherently, such instruments are subject to fluctuations in fair value due to subsequent movements in interest rates. The fair value of cash and cash equivalents, trade and other receivables, securities sold under agreements to repurchase and mortgage loans held for sale consistently approximate the carrying amount due to their short-term nature and are excluded from the above table. The fair value of mortgage-backed and investment securities and off-balance-sheet instruments are based on quoted market prices. Other financial instruments are valued using discounted cash flows. The discount rates used represent current rates for similar instruments.

NOTE 4 - Shareholder Rights Plan

During 1999, the Board of Directors extended the company's Shareholder Rights Plan in which one-half of a preferred stock purchase right (Right) was declared as a dividend for each common share outstanding. Each Right entitles shareholders to purchase, under certain conditions, one one-hundredth of a share of newly issued Series A Junior Participating Preferred Stock at an exercise price of $200. Rights will be exercisable only if a person or group acquires beneficial ownership of 20 percent or more of the common shares or commences a tender or exchange offer, upon consummation of which such person or group would beneficially own 25 percent or more of the common shares. The company will generally be entitled to redeem the Rights at $0.01 per Right at any time until the tenth business day following public announcement that a 20 percent position has been acquired. The Rights will expire on February 20, 2009.

NOTE 5 - Employee Benefit Plans

The company has pension plans covering substantially all employees. Plans covering salaried and non-union hourly employees provide benefits based on compensation and years of service, while union hourly plans are based on negotiated benefits and years of service. The company's policy is to fund amounts on an actuarial basis to accumulate assets sufficient to meet the benefits to be paid in accordance with the requirements of ERISA. Contributions to the plans are made to trusts for the benefit of plan participants.

The company provides medical and insurance benefits to certain eligible salaried and hourly employees who reach retirement age while employed by the company.

The change in benefit obligation, plan assets and the funded status of employee benefit plans follows:

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At year end *(in millions)*	Pension Benefits **1998**	1997	Postretirement Benefits **1998**	1997
Benefit obligation at beginning of year	**$ 507.3**	$ 455.0	**$ 114.9**	$ 104.9
Service cost	**14.7**	13.7	**3.0**	2.7
Interest cost	**37.0**	35.5	**8.3**	8.3
Plan amendments	**2.0**	(0.4)	**—**	(1.6)
Actuarial (gain) loss	**58.3**	28.5	**11.5**	6.7
Termination benefits	**5.8**	1.3	**0.8**	—
Benefits paid	**(28.6)**	(26.3)	**(6.6)**	(7.0)
Retiree contributions	**—**	—	**0.9**	0.9
Benefit obligation at end of year	**$ 596.5**	$ 507.3	**$ 132.8**	$ 114.9
Fair value of plan assets at beginning of year	**$ 628.3**	$ 528.2	**$ —**	$ —
Actual return	**15.3**	126.0	**—**	—
Benefits paid	**(28.6)**	(26.3)	**—**	—
Contributions	**0.5**	0.4	**—**	—
Fair value of plan assets at end of year	**$ 615.5**	$ 628.3	**$ —**	$ —
Funded status	**$ 19.0**	$ 121.0	**$(132.8)**	$ (114.9)
Unrecognized net loss (gain)	**41.3**	(61.1)	**(3.0)**	(15.1)
Prior service costs not yet recognized	**3.2**	1.4	**(9.1)**	(9.9)
Unrecognized net transition obligation (asset)	**(8.2)**	(12.6)	**—**	—
Additional minimum liability	**(5.3)**	—	**—**	—
Prepaid (accrued) benefit cost	**$ 50.0**	$ 48.7	**$(144.9)**	$ (139.9)

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The net prepaid pension benefit cost of $50.0 million at year end 1998 is comprised of pension plans with prepaid benefit cost totaling $75.4 million and accrued benefit liability totaling $25.4 million. Amounts applicable to the company's pension plans with accumulated benefit obligations in excess of plan assets are as follows:

At year end	**1998**	1997
(in millions)		
Projected benefit obligation	**$ 236.2**	$ 12.8
Accumulated benefit obligation	**$ 221.1**	$ 9.9
Fair value of plan assets	**$ 201.6**	$ 0.9

Significant assumptions used for the employee benefit plans follow:

	Pension Benefits			Postretirement Benefits		
For the year	**1998**	1997	1996	**1998**	1997	1996
Weighted average assumptions:						
Discount rate	**6.75%**	7.50%	8.00%	**6.75%**	7.50%	8.00%
Expected long-term rate of return	**9.00%**	9.00%	9.00%	**—**	—	—
Rate of compensation increase	**2.75%**	3.50%	4.00%	**—**	—	—

For measurement purposes, an 8.75 percent annual rate of increase in the per capita cost of covered health care benefits was assumed for 1999. The rate was assumed to decrease gradually to 6.0 percent for 2010, and remain at that level thereafter.

Net periodic benefit cost (credit) for pension and postretirement plans include the following:

	Pension Benefits			Postretirement Benefits		
For the year	**1998**	1997	1996	**1998**	1997	1996
(in millions)						
CHARGES (CREDITS)						
Service cost — benefits earned during the period	**$ 14.7**	$13.7	$12.8	**$ 3.0**	$2.7	$ 2.7
Interest cost on projected benefit obligation	**$ 37.0**	35.5	32.2	**8.3**	8.3	8.5
Expected return on plan assets	**(55.4)**	(46.5)	(41.6)	**—**	—	—
Net amortization and deferral	**(4.9)**	(4.7)	(4.3)	**(1.0)**	(1.3)	(0.4)
Net periodic benefit cost (credit)*	**$ (8.6)**	$ (2.0)	$(0.9)	**$10.3**	$9.7	$10.8

**In addition, in 1998 the company recognized an additional $2.7 million relating to pension benefits and $0.8 million relating to postretirement benefits for curtailments resulting from employee terminations.*

Assumed health care cost trend rates have a significant effect on the amounts reported for the postretirement benefits. A 1 percentage point change in assumed health care cost trend rates would have the following effects:

	1 Percentage Point Increase	1 Percentage Point Decrease
Effect on total of service and interest cost components for the year 1998	$ 1.1	$ (1.0)
Effect on postretirement benefit obligation at year end 1998	$ 11.2	$(10.9)

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NOTE 6 - Stock Option Plans

The company has established stock option plans for key employees and directors. The plans provide for the granting of nonqualified stock options and/or incentive stock options and, prior to 1994, the plans permitted the granting of stock appreciation rights with all or part of any options so granted. Options granted after 1995 have primarily a ten-year term and become exercisable in steps from one to five years.

A summary of stock option activity follows:

For the year	**1998**		1997		1996	
	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price	Options	Weighted Average Exercise Price
(shares in thousands)						
Outstanding beginning of year	**1,430**	**$47**	1,626	$45	1,404	$45
Granted	**654**	**56**	201	56	456	43
Exercised	**(139)**	**38**	(303)	41	(144)	32
Forfeited	**(53)**	**50**	(94)	50	(90)	48
Outstanding end of year	**1,892**	**$51**	1,430	$47	1,626	$45
Weighted average fair value of options granted during the year	**$17.68**		$18.24		$13.07	

Options exercisable at year end were (in thousands): 1998 – 737; 1997 – 658; and 1996 – 769. The weighted average exercise price for options exercisable at year end 1998 was $48 per share, and $46 per share for year end 1997. Exercise prices for options outstanding at year end 1998 range from $12 to $66. The weighted average remaining contractual life of these options is seven years. An additional 2,182,000 and 3,284,000 shares of common stock were available for grants at year end 1998 and 1997, respectively. A restricted stock plan also provides for a maximum of 300,000 shares of restricted common stock to be reserved for awards. At year end 1998, awards of 152,123 shares of restricted common stock were outstanding at an average price of $49.50 per share.

The fair value of the options granted in 1998, 1997 and 1996 was estimated on the date of grant using the Black-Scholes option pricing model with the following assumptions:

For the year	**1998**	1997	1996
Expected dividend yield	**2.0%**	2.1%	2.6%
Expected stock price volatility	**28.7%**	27.3%	26.5%
Risk-free interest rate	**4.8%**	5.6%	6.5%
Expected life of options	**7.0 years**	8.0 years	7.0 years

Assuming that the company had accounted for its employee stock options using the fair value method and amortized such to expense over the options' vesting period, pro forma net income and diluted earnings per share would have been $61.7 million and $1.10 per diluted share in 1998; $49.1 million and $0.87 per diluted share in 1997; and $131.5 million and $2.37 per diluted share in 1996. The pro forma disclosures may not be indicative of future amounts due to changes in subjective input assumptions and because the options vest over several years with additional future option grants expected.

NOTE 7 - Earnings Per Share

Numerators and denominators used in computing earnings per share are as follows:

For the year	**1998**	1997	1996
(in millions)			
Numerator for basic and diluted earnings per share:			
Income before accounting change	**$ 67.7**	$ 50.8	$ 132.8
Accounting change, net of tax	**$ (3.2)**	$ —	$ —
Net income	**$ 64.5**	$ 50.8	$ 132.8
Denominator for basic earnings per share—weighted average shares outstanding	**55.8**	56.0	55.5
Dilutive effect of stock options	**0.1**	0.2	0.1
Denominator for diluted earnings per share	**55.9**	56.2	55.6

NOTE 8 - Accumulated Other Comprehensive Income

The components of other comprehensive income are as follows:

	Currency Translation Adjustments	Unrealized Gains on Available-for-Sale Securities	Minimum Pension Liability	Total
Balance at year end 1996	$(17)	$ (7)	$ —	$(24)
Unrealized gains on available-for-sale securities	—	7	—	7
Deferred taxes relating to unrealized gains on available-for-sale securities	—	(3)	—	(3)
Balance at year end 1997	(17)	(3)	—	(20)
Unrealized gains on available-for-sale securities	—	8	—	8
Deferred taxes relating to unrealized gains on available-for-sale securities	—	(3)	—	(3)
Minimum pension liability	—	—	(4)	(4)
Deferred taxes relating to minimum pension liability	—	—	2	2
Balance at year end 1998	**$(17)**	**$ 2**	**$ (2)**	**$(17)**

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NOTE 9 - Commitments and Contingencies

There are pending against the company and its subsidiaries lawsuits, claims and environmental matters arising in the regular course of business.

In the opinion of management, recoveries, if any, by plaintiffs or claimants that may result from the foregoing litigation and claims will not be material in relation to the consolidated financial statements of the company and its subsidiaries.

NOTE 10 - Segment Information

The company has three reportable segments: paper, building products and financial services. The paper segment manufactures corrugated packaging and bleached paperboard products. The building products segment manufactures a variety of building materials and manages the company's timber resources. The financial services segment operates a savings bank and also engages in mortgage banking, real estate development and insurance activities.

These segments are managed as separate business units. The company evaluates performance based on operating income before special charges, corporate expenses and income taxes. Corporate interest expense is not allocated to business segments. The accounting policies of the segments are the same as those described in the accounting policy notes to the financial statements. Corporate and other includes corporate expenses and special charges.

For the year or at year end **1998** *(in millions)*	Paper	Building Products	Financial Services	Corporate and Other	Total
Revenues from external customers	**$ 2,017.6**	**$ 613.0**	**$ 1,109.5**	**$ —**	**$ 3,740.1**
Depreciation, depletion and amortization	**206.6**	**52.9**	**18.2**	**4.1**	**281.8**
Operating income	**32.5**	**112.5**	**154.1**	**(75.3)***	**223.8**
Financial Services, net interest income	**—**	**—**	**243.5**	**—**	**243.5**
Total assets	**2,486.6**	**1,043.2**	**12,399.6**	**60.9**	**15,990.3**
Investment in equity method investees	**7.7**	**29.4**	**2.8**	**—**	**39.9**
Capital expenditures	**96.5**	**73.1**	**38.9**	**5.6**	**214.1**

**Includes a special charge of $47.4 million, of which $37.5 million applies to the paper segment and $9.9 million applies to the building products segment.*

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(in millions)	Paper	Building Products	Financial Services	Corporate and Other	Total
For the year or at year end 1997:					
Revenues from external customers	$ 2,062.9	$ 617.3	$ 945.2	$ —	$ 3,625.4
Depreciation, depletion and amortization	204.7	50.2	15.5	3.4	273.8
Operating income	(39.0)	131.1	132.1	(24.6)	199.6
Financial Services, net interest income	—	—	220.7	—	220.7
Total assets	2,609.9	913.7	10,784.7	55.7	14,364.0
Investment in equity method investees	7.1	19.2	3.8	—	30.1
Capital expenditures	150.6	68.7	17.7	13.5	250.5
For the year or at year end 1996:					
Revenues from external customers	$ 2,082.3	$ 562.6	$ 815.4	$ —	$ 3,460.3
Depreciation, depletion and amortization	197.9	45.8	12.4	3.9	260.0
Operating income	113.0	102.0	63.1	(17.2)	260.9
Financial Services, net interest income	—	—	195.5	—	195.5
Total assets	2,701.7	870.5	9,335.1	39.8	12,947.1
Investment in equity method investees	6.2	21.2	0.9	—	28.3
Capital expenditures	143.8	122.6	15.1	8.9	290.4

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The following table of data includes revenues, property and equipment based on the location of the operation.

GEOGRAPHIC INFORMATION

(in millions)	**1998**	1997	1996
For the year: Revenues from external customers			
United States	**$ 3,629.8**	$ 3,535.9	$ 3,391.0
Canada	**3.6**	—	—
Mexico	**64.2**	49.7	41.8
South America	**42.5**	39.8	27.5
Total	**$ 3,740.1**	$ 3,625.4	$ 3,460.3
At year end: Property and equipment			
United States	**$ 2,805.9**	$ 2,847.5	$ 2,871.3
Canada	**55.6**	—	—
Mexico	**26.6**	27.9	18.5
South America	**39.6**	40.9	41.1
Total	**$ 2,927.7**	$ 2,916.3	$ 2,930.9

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NOTE 11 - Summary of Quarterly Results of Operations (Unaudited)

Selected quarterly financial results for the years 1998 and 1997 are summarized below:

(in millions, except per share amounts)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1998*				
Total revenues	**$ 944.6**	**$ 940.7**	**$ 943.7**	**$ 911.1**
Manufacturing net sales	**682.2**	**671.2**	**667.4**	**609.8**
Manufacturing gross profit	**98.0**	**108.4**	**104.1**	**84.1**
Financial Services operating income before taxes	**36.7**	**41.0**	**36.1**	**40.3[a]**
Net income:				
Income before accounting change	**26.4**	**34.6**	**24.4**	**(17.7)[b]**
Accounting change, net of tax	**(3.2)**	**—**	**—**	**—**
Net Income	**$ 23.2**	**34.6**	**24.4**	**(17.7)**
Earnings per share:				
Basic:				
Income before accounting change	**$ 0.47**	**$ 0.62**	**$ 0.44**	**$ (0.32)**
Accounting change, net of tax	**(0.06)**	**—**	**—**	**—**
Basic earnings per share	**$ 0.41**	**$ 0.62**	**$ 0.44**	**$ (0.32)**
Diluted:				
Income before accounting change	**$ 0.47**	**$ 0.62**	**$ 0.44**	**$ (0.32)**
Accounting change, net of tax	**(0.06)**	**—**	**—**	**—**
Diluted earnings per share	**$ 0.41**	**$ 0.62**	**$ 0.44**	**$ (0.32)**
1997				
Total revenues	$ 850.9	$ 907.9	$ 938.4	$ 928.2
Manufacturing net sales	649.0	687.1	678.2	665.9
Manufacturing gross profit	81.9	84.9	75.8	89.8
Financial Services operating income before taxes	29.5	32.4	37.4	32.8
Net income	13.2	15.6	12.6	9.4
Earnings per share:				
Basic	$ 0.24	$ 0.28	$ 0.22	$ 0.17
Diluted	$ 0.24	$ 0.28	$ 0.22	$ 0.17

**First quarter 1998 restated for the cumulative after-tax effect of the change in method of accounting for start-up costs.*
[a]*Includes $10.0 million gain on sale of investment property.*
[b]*Includes special charge of $47.4 million.*

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Report of Management

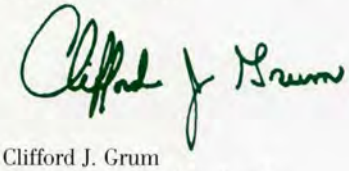
MANAGEMENT REPORT ON FINANCIAL STATEMENTS

Management has prepared and is responsible for the company's financial statements, including the notes thereto. They have been prepared in accordance with generally accepted accounting principles and necessarily include amounts based on judgments and estimates by management. All financial information in this annual report is consistent with that in the financial statements.

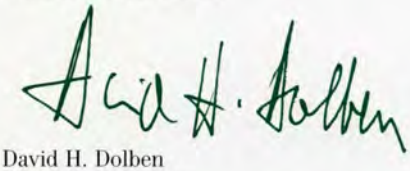
The company maintains internal accounting control systems and related policies and procedures designed to provide reasonable assurance that assets are safeguarded, that transactions are executed in accordance with management's authorization and properly recorded, and that accounting records may be relied upon for the preparation of financial statements and other financial information. The design, monitoring and revision of internal accounting control systems involve, among other things, management's judgment with respect to the relative cost and expected benefits of specific control measures. The company also maintains an internal auditing function that evaluates and formally reports on the adequacy and effectiveness of internal accounting controls, policies and procedures.

The company's financial statements have been examined by Ernst & Young LLP, independent auditors, who have expressed their opinion with respect to the fairness of the presentation of the statements.

The Audit Committee of the Board of Directors, composed solely of outside directors, meets with the independent auditors and internal auditors to evaluate the effectiveness of the work performed by them in discharging their respective responsibilities and to assure their independent and free access to the committee.



Clifford J. Grum
Chairman of the Board and
Chief Executive Officer



David H. Dolben
Vice President and
Chief Accounting Officer

Report of Independent Auditors

TO THE BOARD OF DIRECTORS AND SHAREHOLDERS OF TEMPLE-INLAND INC.:

We have audited the accompanying consolidated balance sheets of Temple-Inland Inc. and subsidiaries as of January 2, 1999, and January 3, 1998, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended January 2, 1999. These financial statements are the responsibility of the company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Temple-Inland Inc. and subsidiaries at January 2, 1999, and January 3, 1998, and the consolidated results of their operations and their cash flows for each of the three years in the period ended January 2, 1999, in conformity with generally accepted accounting principles.

As discussed in Note A to the financial statements, in 1998 the company changed its method of accounting for start-up costs.



Houston, Texas
January 29, 1999

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Directors and Officers

Board of Directors

Temple-Inland Inc.

Robert Cizik (2) (3) (5) (6)

Anthony M. Frank (1) (2) (3) (4)
Chairman
Belvedere Capital Partners, Inc.

Clifford J. Grum (3)
Chairman and Chief Executive Officer
Temple-Inland Inc.

William B. Howes
Chairman and Chief Executive Officer
Inland Paperboard and Packaging, Inc.

Bobby R. Inman (2) (3) (4)

Kenneth M. Jastrow, II
President, Chief Operating Officer and Chief Financial Officer
Temple-Inland Inc.

Herbert A. Sklenar (1) (2) (3) (4)
Chairman Emeritus
Vulcan Materials Company

Walter P. Stern (4) (6)
Vice Chairman
Capital Group International, Inc.

Arthur Temple III (2) (6)
Chairman and Chief Executive Officer
Exeter Investment Company

Charlotte Temple (1) (5)

Larry E. Temple (1) (3) (5)
Attorney

Advisory Director
Paul M. Anderson
President and Chief Executive Officer
Broken Hill Proprietary Company, Ltd.

(1) Audit Committee

(2) Management Development and Executive Compensation Committee

(3) Executive Committee

(4) Corporate Governance Committee

(5) Public Policy/Environmental Committee

(6) Finance Committee

Officers

Temple-Inland Inc.

Clifford J. Grum
Chairman and Chief Executive Officer

Kenneth M. Jastrow, II
President, Chief Operating Officer and Chief Financial Officer

William B. Howes
Executive Vice President

Harold C. Maxwell
Group Vice President

Jack C. Sweeny
Group Vice President

Joseph E. Turk
Group Vice President

M. Richard Warner
Vice President, General Counsel and Secretary

David H. Dolben
Vice President and Chief Accounting Officer

David W. Turpin
Treasurer

Paper Group

William B. Howes
Chairman and Chief Executive Officer
Inland Paperboard and Packaging, Inc.

Bart J. Doney
Executive Vice President, Packaging Group
Inland Paperboard and Packaging, Inc.

James C. Foxworthy
Executive Vice President, Paperboard Group
Inland Paperboard and Packaging, Inc.

Joseph E. Turk
Executive Vice President, Inland Eastex

Building Products Group

Harold C. Maxwell
Chairman and Chief Executive Officer
Temple-Inland Forest Products Corporation

Forests Group

Jack C. Sweeny
Group Vice President, Temple-Inland Forest
Temple-Inland Forest Products Corporation

Financial Services Group

Kenneth R. Dubuque
President and Chief Executive Officer
Guaranty Federal Bank, F.S.B.

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Shareholder Information

Transfer Agent and Registrar

First Chicago Trust Company of New York
P.O. Box 2500
Jersey City, New Jersey 07303-2500
201.324.1225

Independent Auditors

Ernst & Young LLP
Houston, Texas

Annual Meeting

The annual meeting of shareholders of Temple-Inland Inc. will be held at the company's corporate headquarters, 303 South Temple Drive, Diboll, Texas, on May 7, 1999, at 9:00 a.m. local time.

Stock Listing

Temple-Inland Inc. common stock is listed on the New York Stock Exchange and the Pacific Exchange, ticker symbol TIN.

Number of Shareholders

As of December 31, 1998, there were 6,789 shareholders of record of the company's common stock.

Dividend Reinvestment Plan

Temple-Inland offers its shareholders a convenient and economical way to increase their investment in the company's common stock through the purchase of additional shares with quarterly dividends and optional cash payments. Under the Temple-Inland Inc. Dividend Reinvestment Plan, administered by First Chicago Trust Company of New York, Temple-Inland pays the brokerage fees and service charges, and the shareholder receives the benefit of larger quantity purchases and optional free custodial services. For more information about the Plan, contact First Chicago Trust Company of New York, Dividend Reinvestment Plans, P.O. Box 13531, Newark, New Jersey 07188-0001.

Form 10-K

A copy of Temple-Inland Inc.'s annual report on Form 10-K, as filed with the Securities and Exchange Commission, will be sent without charge upon written request made to the company's Shareholder Relations Department.

Mailing Address

Temple-Inland Inc.
Drawer N
Diboll, Texas 75941
409.829.1313

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